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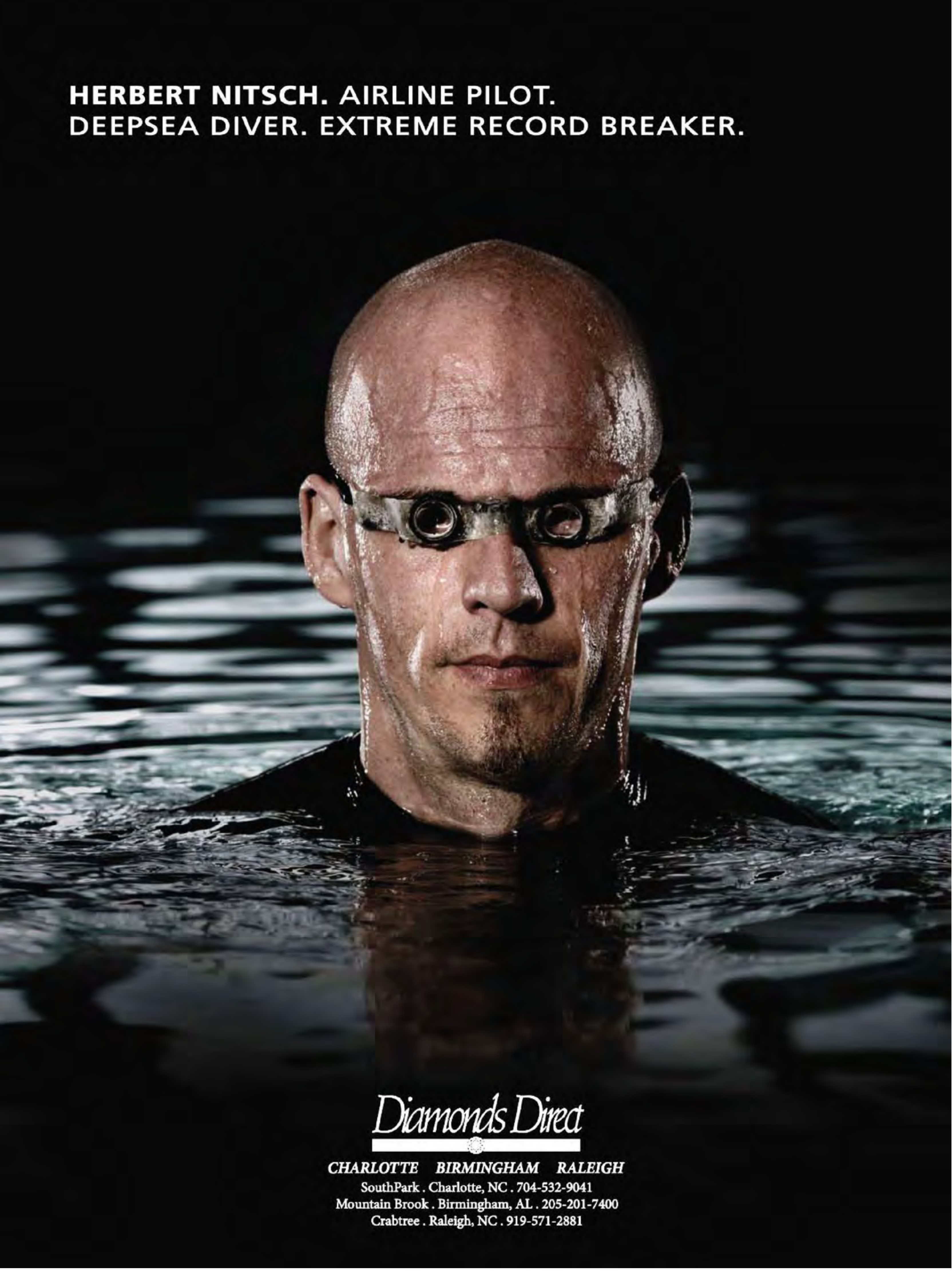
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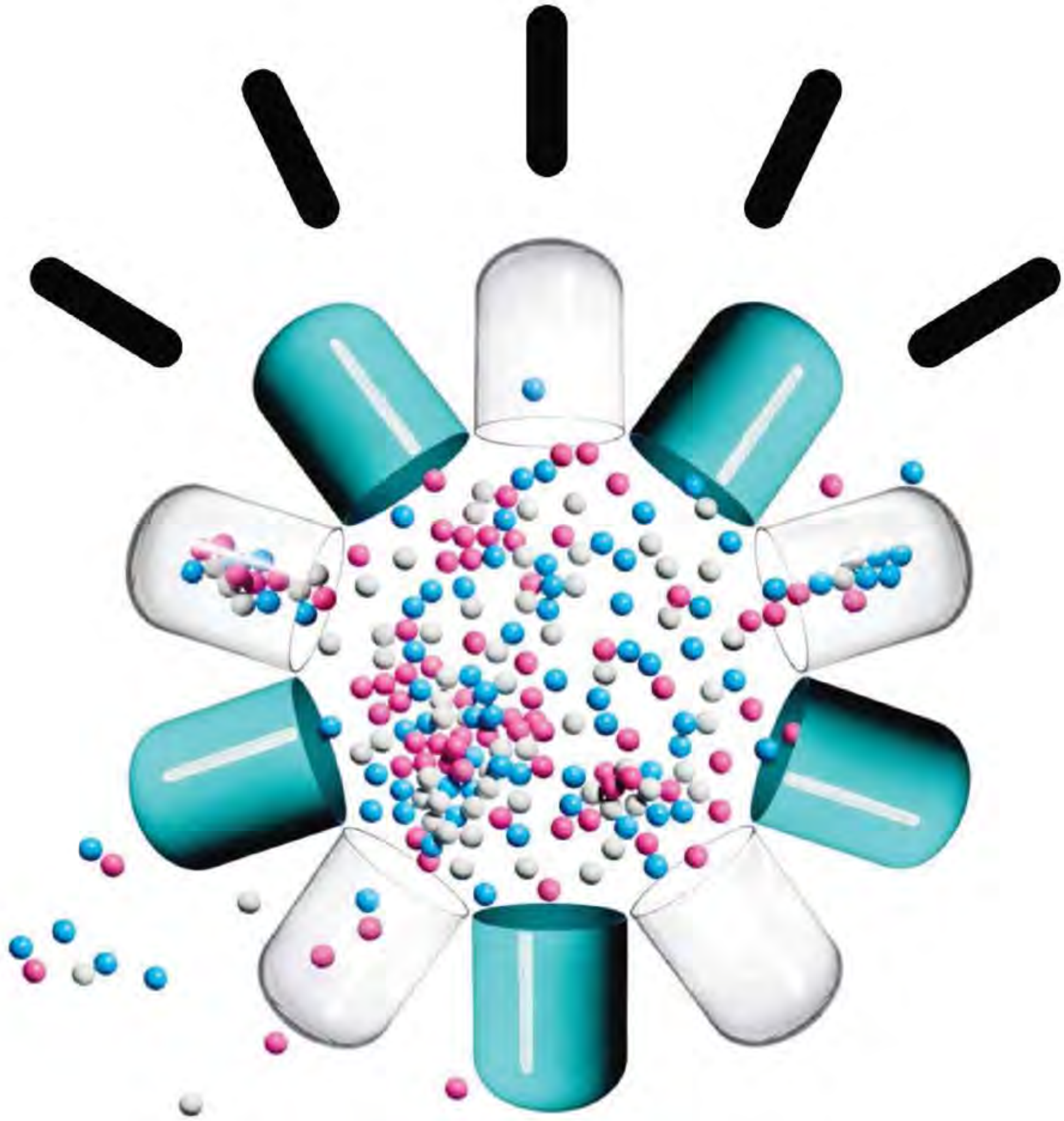
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Corrections & Clarifications

● "Innovator: Tod Dykstra" (June 14-June 20) erred in describing SFpark as a city agency instead of city program. Dykstra did not work on a Pentagon-funded program but worked for Dust Networks, the venture-backed company created out of that research. ● A graphic in "AIG's Declaration of Independence" (June 7-June 13) mistakenly used a logo for National Western Life Insurance. Western National Life is a subsidiary of AIG, not National Western Life.

How to Reach Us

Editorial: 212-617-6231
Sales: 212-617-2900
Circulation: 800-635-1200
Address: 731 Lexington Ave., New York, NY 10022
Letters to the Editor can be sent by email, fax, or regular mail. They should include address, phone number(s), and email address if available. Connections with the subject of the letter should be disclosed, and we reserve the right to edit for sense, style, and space.
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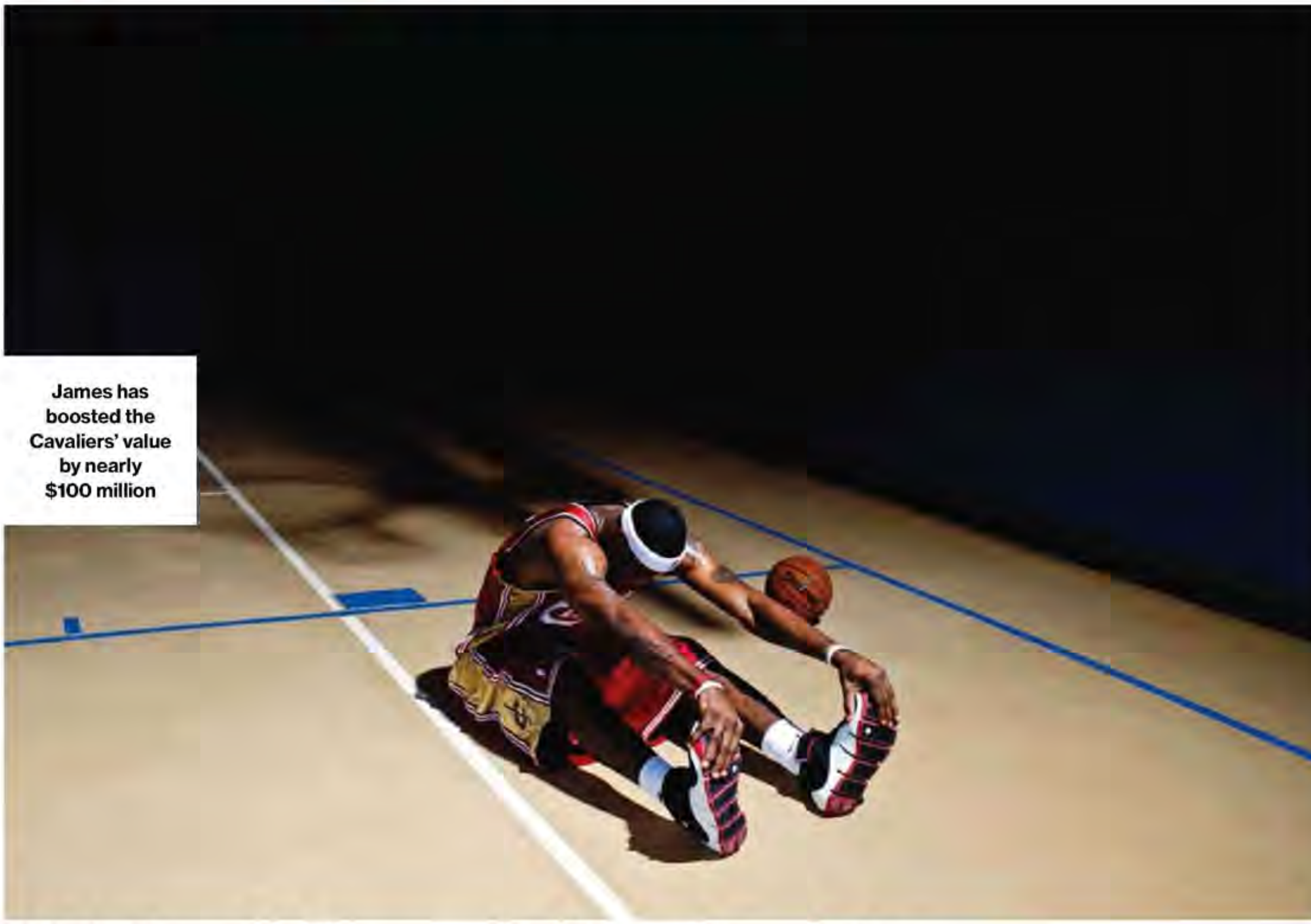
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Opening Remarks



James has boosted the Cavaliers' value by nearly $100 million

FINLAY MACKAY/TRUNK ARCHIVE

A Problem Like LeBron

When you have a superstar employee, how do you not end up working for him?
By Ira Boudway

The hardest problems in business are the ones that money alone can't solve. A gushing oil leak on the ocean floor is one example. LeBron James is another. When the 25-year-old aspiring "global icon" becomes a free agent on July 1, his price will be fixed. The rules worked out by the National Basketball Assn. owners and players union dictate that as a seven-year veteran, James can receive more than 30 percent of a team's salary cap, which is projected to be $56.1 million next year. The Cleveland Cavaliers, his current employer and hometown team, can offer a six-year contract while the competition can offer only five, but regardless of where he signs, James will have to survive on an average of about $20 million a year.

James is quite a bit more valuable than that. The Cavaliers had the NBA's best regular-reason record this year; should James sign elsewhere, they will immediately sink to the middle of the league pack, if not lower. The psychic blow—to the team, the city, the entire Rust Belt—would be even greater. The pressure to persuade James to stay is enormous. In a press conference the day after the Cavaliers were eliminated from the playoffs, team owner Dan Gilbert, a normally voluble entrepreneur who built the Quicken Loans mortgage empire from the ground up, labored under the load. His voice trailed off at the end of sentences, and he laughed feebly at his own jokes. "We have to ignore the noise," he said flatly. "We are focused on building the best franchise, the best environment, the best place for a long-term situation for LeBron or any free agent that we want to come here."

Cavaliers owner Dan Gilbert has been adamant that he won't beg or grovel to get James to stay in Cleveland

Gilbert bought the Cavaliers for $375 million in 2005, halfway through James's second year with the team. He has been adamant that he won't beg or grovel for James to stay—

Opening Remarks

"I bet there are fewer lawyers who actually try billion-dollar, bet-your-company cases to verdict with consistency than there are big-ticket basketball players"
Fred Bartlit Jr.

and that's a logical negotiating stance. Doing so would acknowledge that the value of his investment rides on the whims of a single employee who is half his age. Guess what? It does anyway. When James joined the team, home attendance at Cavaliers games went up 59 percent. This season, the team sold out all 41 home games for the first time in franchise history, and the Cavaliers were shown on national television as often as the Lakers and Celtics. Gilbert may own the Cavaliers, but James owns Gilbert.

In a 2009 study titled "Should Investors Bet on the Jockey or the Horse?" in *The Journal of Finance,* Steven Kaplan, an expert on executive compensation at the University of Chicago Booth School of Business, found that the answer, generally, is the horse. "In most businesses, what you find is that the core attribute is not the people, it's the business," he says. "Warren Buffett has a famous saying, which I think is supported by the data: 'When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is usually the reputation of the business that remains intact.'"

Kaplan's analysis presumes that value is sprinkled somewhat evenly across an organization. LeBron-style problems emerge when one entity is disproportionately responsible for value-creation. Sports franchises are obvious examples, though hardly the only ones.

The economics of the legal profession is also skewed by larger-than-life talent that demands larger-than-life compensation. Twenty years ago, at the law firm Kirkland & Ellis, Fred Bartlit Jr. was LeBron James in pinstripes. Bartlit, now best known for representing George W. Bush in *Gore v. Bush* in 2000, had distinguished himself as a powerful trial lawyer who attracted big clients. The compensation structure at Kirkland, as at most large firms, however, was based primarily on seniority and hours billed. Frustrated by the difference between his perceived value and his paycheck, Bartlit persuaded Kirkland to adopt a pay-by-results system for him and his group. "I originally thought that the model of getting paid for the value you bring could co-exist within an hourly firm," Bartlit says. But the two systems didn't work together. As a result, Bartlit left Kirkland in 1993 and founded Bartlit Beck Herman Palenchar & Scott.

Bartlit, whose Chicago office uses a two-story basketball court as a conference room, sees the parallels between big-time trial lawyers and big-time basketball players. "I bet there are fewer lawyers who actually try billion-dollar, bet-your-company cases to verdict with consistency than there are big-ticket basketball players," he says. "When we go for interviews on these big cases, we often see the same four or five lawyers. I had one on the West Coast recently, and in the lobby of the hotel as we were getting reading, I saw David Boies [his opponent in *Gore v. Bush*]."

Boies, adds Bartlit, is another star who could not get what he perceived to be fair value for his services within the culture of an established firm. (Boies famously left Cravath, Swaine & Moore in 1997 to start Boies, Schiller & Flexner.) For Bartlit, this is the natural way of things: Talented lawyers with an appetite for risk eventually feel undervalued enough to strike out on their own.

James doesn't have the option of leaving the Cavaliers for his own firm. While he might one day find himself with the means to buy a team, for now he's restricted to working for the cartel of 30 NBA owners in the much the same way that movie stars are stuck negotiating with the so-called Big Six studios (Warner Bros., Fox, Paramount, Sony, Disney, and NBC Universal). But where NBA owners formally band together under the auspices of a commissioner to protect themselves from the foolish and free-spending among them, studio heads simply keep a common discipline against prodigal spending.

Still, LeBron problems can emerge when movie stars gain leverage from associations with a hit franchise, as Toby Maguire did after the original installment of *Spider-Man.* After receiving $4 million to star in a movie that grossed $820 million worldwide, Maguire renegotiated his deal to get $17 million for the sequel and $15 million, plus a heavy cut of the gross, for the third. But when the director Sam Raimi balked at a budget for the fourth installment that he considered too low, the studio delayed production and dumped Raimi, Maguire, and his co-star Kirsten Dunst. In an industry where only

Buckrakers



Fred Bartlit Jr.
Trial lawyer who has a basketball court for a conference room



David Boies
Famously split from Cravath, Swaine & Moore



James Patterson
Published nine novels and sold 14 million copies overall last year



Toby Maguire
Got $4 million for the first *Spider-Man,* $17 million for sequel

CLOCKWISE FROM TOP LEFT: JIM YOUNG/REUTERS; RICK MAIMAN/BLOOMBERG/GETTY; SONY PICTURES/EVERETT COLLECTION; NEWSCOM

the most ardent viewers can discern a Ryan Gosling from a Ryan Reynolds, such things are possible, albeit risky. *Spider-man 4* is in limbo, and replacement stars in franchise movies can tank. See *Dumb and Dumberer*. Better yet, don't.

If there's a common strategy among successful managers with LeBron problems, it's to stop negotiating and start seducing: What does LeBron James need that money can't buy? "A world-class athlete is fundamentally no different than a world-class scientist," says Michael M. Crow, the president of Arizona State University. "They are interested in finding a way to express everything that they have without limit so that they can gain recognition." President E. Gordon Gee of Ohio State University likens himself to an "institutional psychiatrist," someone who recruits people who would be successful anywhere but require the constant reassurance that their institution believes in them. Reassurance can be time-consuming, and it requires adjustments in organizational culture. On the other hand, it's also free.

Best-selling novelist James Patterson dominates the publishing industry in much the same way James does the NBA. Some titles sell better than his, but no author can compete on volume. Last year Patterson sold 14 million copies while publishing nine new books. He holds the all-time record with more than 50 *New York Times* best sellers to his name. Patterson is well compensated—*Forbes* valued his current 17-book deal at $150 million—and money is not terribly important to him. "I'm not particularly interested in squeezing every penny out that I possibly could," he says. Instead, Patterson wants a commitment from his publisher to work hard and make a big deal of everything he does.

Movie studios, naturally, are expert at this kind of pampering. "Tom Cruise has a caterer he's been using since the



The LeBron Effect
University of Illinois at Chicago economist John W. Skorburg estimates that at least 5 percent of the population in these NBA markets would spend an extra $100 during a (LeBron-induced) playoff game. Above is how the numbers add up.

movie *The Firm*," says Edward Jay Epstein, author of *The Hollywood Economist* and expert witness in film contract disputes. "If he complains he has a stomachache, you're delaying the movie at a cost of $300,000 a day, so you're not going to screw around with the caterer. Makeup, trainers, security, all that, the star will get." Studios will go so far as to give bit parts to the members of a star's entourage. "The point of these people is to make the star happy and make the movie work, it's not really a negotiation as much as an accommodation," says Epstein.

Bartlit says he keeps the partners at his firm happy not just by paying them well, but also by giving them the chance to do what they most love to do—fight in court. "People get in court all the time," he says. "I think something like 94 percent of our lawyers took a witness to the trial

Of all the teams in the NBA, only the Cavaliers have proven they can't win it all with James

last year." He believes the same holds for players like James; the money has to be there, but the real gratification is in offering them a chance to compete and win.

Dan Gilbert has tried seduction. Three years ago, the Cavaliers opened a $25 million, 50,000-square-foot, state-of-the-art practice facility, which just happened to be convenient to James's 33,000 sq.-ft. home in Summit County. Since the season ended, both the team's general manager and coach have left, fueling speculation, denied by Gilbert, that the moves were made at James's behest.

The Cavaliers and their fans have been shameless—and shrewd—in selling James on the sentimental appeal of staying home. A billboard near the Cavaliers' Quicken Loans Arena hopefully declares, "Born Here. Raised Here. Plays Here. Stays Here." Both President Barack Obama and NBA Commissioner David J. Stern have noted the appeal of James re-signing with Cleveland.

Yet when money is equal and emotional appeals have been exhausted, it comes down to winning, a currency of its own, and one that James has said he is most passionate about. Outside of professional sports, few things are as unambiguously precious as a championship. Here, Cleveland is at a distinct disadvantage; of all the teams in the NBA, only the Cavaliers have proven they can't win it all with James—seven years, no titles. Chicago has the most talented supporting cast and can offer James his best chance at an immediate trophy. New York owns the greatest story line—a marquee franchise starved for a hero—and the city itself promises to make winners of anyone who moves there. On paper, Gilbert and the Cavaliers can't win, yet they clearly can't afford to lose. The reason they're so vulnerable is the same reason they have a shot—because it all comes down to one guy. The only thing worse than a LeBron problem is no LeBron.

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Global Economics



Afghan Mineral Wealth: No Easy Road for Westerners

▶ **War, chicanery, and corruption will likely keep the estimated $1 trillion trove just out of reach**

▶ **"These resources are not worth anything if you can't ... get them out of the ground"**

When the Pentagon announced last week that Afghanistan is sitting on mineral wealth worth $1 trillion—one thousand times the government's annual revenues—the resulting excitement overshadowed one simple fact. Much of the wealth is inaccessible due to war, political chicanery, and outright corruption. At a time when the Obama Administration could use some good news from Afghanistan, the Pentagon was just restating what already was known.

"The raw data they were using dates back to the '70s and '80s," says Stan Coats, former principal geologist for the British Geological Survey. "These resources are not worth anything if you can't get there or don't have enough security to get them out of the ground."

In 2004, when a U.S. Geological Survey caravan set out through the northern emerald district, it was escorted by five armored Land Cruisers and two pickups equipped with bed-mounted machine guns. Mines, encampments, and regular convoys can be even harder to secure (page 16). No major Western mining company is likely to place large bets amid such instability, Coats and other experts say.

Afghan regulations require exploration companies to register their findings with the government, then bid

Afghan licensing regulations add to the uncertainty by requiring exploration companies to register their findings with the government, which then puts the resources out to bid. "You're not going to see a lot of Western interest in going out to expend scarce exploration dollars just to be outbid by the Chinese or someone else with more influence," says Jim Yeager, a U.S. consulting geologist who advised the Afghan Mining Ministry on the 2007 tender of the 6 million-ton Aynak copper deposit.

Afghanistan's mining minister,

REUTERS

Wahidullah Shahrani, visited London on June 25 in an attempt to rekindle investor interest in the 1.8 billion-ton Hajigak iron ore deposit, 60 miles west of Kabul. Shahrani canceled previous bids on the deposit in February, just weeks after replacing his predecessor, Mohammad Ibrahim Adel, who was linked in published accounts to taking more than $20 million in bribes on a previous mining license. He denies the allegation.

"Afghanistan has no capacity to manage these resources in a transparent, equitable fashion, so inevitably it will be the warlords who will be the beneficiaries and collect the resource rents," says Michael Klare, professor of Peace and World Security Studies at Hampshire College in Amherst, Mass., and author of the 2008 book *Rising Powers, Shrinking Planet*.

The U.S. Defense Dept.'s report promoted Afghanistan's minerals trove as a path to "economic sovereignty." It tallied $908 billion in copper, iron, gems, and precious metals. More than two-thirds of Afghanistan's resources are yet to be quantified, the report said. Paul Brinkley, director of the Pentagon's Task Force for Business and Stability Operations in Afghanistan, acknowledged at a press briefing that unearthing the treasure "is not a quick win."

In 2007, the China Metallurgical Group Corp. (MCC), a state-owned enterprise, won the right to mine the Aynak copper concession, 21 miles south of Kabul, with a $1.8 billion tender, including $800 million to be paid over the first five years. Then the company built a road to the site of its camp, erected 65 guard posts, and cleared land mines from 3 million square meters of terrain. Ore production, originally slated for 2012, will begin in 2014, according to Ministry of Mines spokesman Jaward Omar.

MCC and two other companies dropped out of the Hajigak bidding before it was scrapped, Shahrani's deputy, Abdul Qudus Hamidi, said in February. Notably absent, after nearly a decade of U.S.-led war against the Taliban and al-Qaeda terrorists, were any North American, European, or Australian companies.

—Elliot Blair Smith, Eltaf Najafizada, and James Rupert

The bottom line *The Pentagon's projection of $1 trillion in Afghan mineral wealth turned heads, but it may be putting the hype in hypothetical.*



Ho Chi Minh City: Vietnam is lowering tariffs and improving its infrastructure

Asia

Vietnam: An Asian-Tiger Wannabe (Again)

- ▶ Vietnam aims to lure investment away from China and India
- ▶ "We're cheaper—much cheaper," says a Vietnamese executive

Has Vietnam's moment finally arrived? Explosive wage growth and labor strife in China and India, favored destinations for foreign investment in Asia, have multinationals taking a serious look at Vietnam as a low-cost alternative for new factories and call centers. "We're cheaper–much cheaper," says Nguyen Than Nam, chief executive officer of FPT, a Hanoi-based IT outsourcer and distributor of cell phones with $1 billion in revenue last year. Vietnam is ready to compete head-on for foreign investment, says Nam. "We are trying to be the 'one.'"

Executives and investors have heard this kind of talk from Vietnam before, only to come away disappointed. After the end of the U.S. trade embargo in 1994 there was a rush of companies such as Coca-Cola and Procter & Gamble into Vietnam. Many ultimately were turned off by the bureaucracy and corruption. This time around Hanoi is moving more decisively. President Nguyen Minh Triet's government has cut taxes, such as import duties on personal computer parts, and is promising to improve the country's roads and ports. It's building nuclear power plants and a high-speed train line from the capital to Ho Chi Minh City. The leadership also vows to eliminate some of the notorious red tape that has frustrated investors.

Vietnam's $96 billion economy is far less centrally controlled than last decade, and the country, which boasts one of the youngest workforces in the world, managed to gain membership in the World Trade Organization in 2007. The country last year exported $12.3 billion of goods to the U.S., its biggest overseas market.



Foreign direct investment is on the rise and could double, to $15 billion this year according to a May 31, report analysts at Standard Chartered Bank.

This fall, Intel will open a $1 billion chip assembly and test plant near Ho Chi Minh City. Taiwanese laptop PC manufacturer Compal also has a new factory in Vietnam. Arthur Chiao, chairman of the Taiwan Electronics & Electrical Appliances Assn., on June 7 said his group is helping Taiwanese companies find new manufacturing sites in Vietnam in the wake of rising labor costs on the mainland.

Political tensions in Thailand next door also are leading companies to Vietnam. Calm has returned to the Thai capital after May's deadly confrontations in Bangkok between antigovernment protesters and the military, but it was one of many political outbursts in Thailand over the years. Pleasanton (Calif.)-based Polycom buys 80 percent of its video-conferencing equipment from Thailand, says Hansjoerg Wagner, head of the company's Asia operations: "With all the political issues that are ongoing there, we are looking at contingency plans," he says. Vietnam, one of Polycom's fastest-growing markets in Asia, "is on our target list" as an alternative.

Not everyone sees a big manufacturing exodus from other parts of Asia to Vietnam, especially given China's economic scale and far more advanced infrastructure. Even though costs have gone up in southern China's Pearl River Delta, companies can acquire goods from factories in less expensive parts of the country, like Tianjin or Qingdao in northern China. Before relocating to Vietnam "you would have to exhaust all the places in China," says Dan Berman, director of Langton, a Hong Kong-based supplier of stuffed animals and other toys to customers like Tesco and Toys 'R' Us.

Vietnam boosters disagree. Don Lam, chief executive of investment firm VinaCapital Group, which manages $1.8 billion in assets in the country, points to the new highways the government is building to connect northern Vietnam to southern China. Those roads will enable Vietnamese factories to become part of Chinese supply chains more easily, Lam says, with a cost base that's at least a third lower than across the border. With China-based employers likely to feel the need to match raises offered recently by Honda, Foxconn, and others, that wage differential is only going to grow larger, he promises. "If people are thinking of relocating," says Lam, "now is the time."
—*Bruce Einhorn*

The bottom line *Vietnam hopes to attract investment that otherwise might go to India and China, with new tax policies and infrastructure projects.*

Jobs

For Small Business, the Big Decision is Hiring

- Though sales are up, Blinds.com worries about adding workers
- "We've never looked at outsourcing the 70-person call center"

Hiring dominates the conversation these days at the weekly meeting Jay Steinfeld (below) holds in his office with his senior team at **Blinds.com**. Despite an anemic economy, business at the 110-employee Houston e-tailer is brisk. Revenues are expected to hit $80 million by yearend, up 63 percent from 2009, helped in part by the recent acquisition of a rival's assets. Steinfeld, 56, who says his company sells more window blinds online than **Home Depot** and **Lowes** combined, has added 35 new employees since the start of the year. Nevertheless, he finds himself agonizing "almost every day" over



FROM TOP: KEVIN GERMAN/LUCEO; PHOTOGRAPH BY JEFF WILSON FOR BLOOMBERG BUSINESSWEEK

Global Economics



Remembering a legend of song and sausage page 23 ▶

whether to hire 10 additional staffers for the company's in-house call center.

Blinds.com's caution is shared by small employers across the country. Though recent surveys show an uptick in confidence among small business owners, that hasn't translated into an upswing in hiring. The national jobless rate remains lodged above 9 percent, and only about 500,000 private-sector jobs have been created in the first five months of the year. The slow pace of the recovery hasn't stopped President Barack Obama from continuing to trumpet the notion that small businesses such as Blinds.com are going to "be the engine of job growth." Over the past week, Obama has stepped up pressure on Congress to pass legislation he's been pushing for months meant to spark hiring by small employers. On June 15, the House approved the Small Business Jobs Tax Relief Act, which would provide tax breaks for small businesses to encourage them to create jobs. Separate legislation being considered in the House would create a $30 billion fund to increase community bank lending to small businesses.

On a June morning in Steinfeld's office, government initiatives weren't top of mind. Steinfeld says his business is profitable and has "plenty of cash," so he can afford to take on new staff. Yet he's worried about the state of the housing market, crucial for any home furnishings retailer. "Even if it does turn around," he says, "it's going to take a while to build those houses. And everyone we've spoken to in the industry does not believe it's going to come back to where it used to be—maybe ever."

That makes it hard for Steinfeld to figure out how many new call-center employees, who earn between $30,000 and $70,000, to hire. To help him decide, the Blinds.com chief brought in a consultant to work with Chief Financial Officer Marilynne Franks and Chief Operating Officer Steve Riddell. "In a small business like ours, managing payroll costs is crucial," says Riddell. Steinfeld interjects: "And that which we have the most control of. Morale would be horrible if we hired, then turned around and terminated. Then we're back to where a lot of other companies are."

While selling blinds online might not sound like a complicated business, the trick to making it work is finding and training call-center reps who can explain the intricacies of thousands of varieties of blinds to customers—and fix problems when something goes wrong. Adding to the complexity: In addition to selling blinds under its own name, Blinds.com also handles online sales of window coverings for **Sears.com** and 11 other retailers and sites. "We've never looked at outsourcing the 70-person call center, even though it would have provided significant cost savings," says Chief Marketing Officer Daniel Cotlar. "This isn't selling CDs."

Steinfeld is taking into consideration some of the Obama Administration's incentives to hire. "One of the things that's really helped us is the accelerated depreciation for taxes in Section 179 [of the tax code]," he says. The Hiring Incentives to Restore Employment Act's tax credit for hiring unemployed workers, which took effect in March, will pay off, too. CFO Franks figures the company will be eligible for tax credits for 8 or 10 of the 35 employees it has brought in since the beginning of the year. "We've got to make sure what we do is measured," he says. "We'll take chances here and there, but we're not going to bet the farm." As *Bloomberg Businessweek* went to press, Steinfeld had not yet made a decision. —*Nick Leiber*

***The bottom line** For small companies, the decision to hire is particularly difficult right now. Government incentives help, though only a little.*

Sustainable Energy

Of Greenbacks and Green Power

When it comes to green energy, cash is king. Spain and Germany, which attracted a combined $81 billion in investment to fund wind and solar projects since 2005, now produce almost one-third of their electricity from renewable sources, vs. just 4% for the U.S. Not to be outdone, the world's emerging giants have targeted green energy as an engine for growth. China, for instance, has earmarked $46.9 billion from its two-year stimulus package to fund eco-projects. —*Mark Scott*

	U.S.	Brazil
	The BP oil spill has focused attention on America's dependence on fossil fuels. President Obama has pledged to pass energy legislation that would provide regulatory certainty for investors.	The South American giant has big plans: By 2019, it will spend $17.7 billion on eco-projects, including a sixfold increase in its wind capacity, to six gigawatts.
Green power sources (gigawatts)*	53.4 GW	11.7 GW
Green power as a share of total capacity (%)	4.0%	11.0%
Investment in clean energy**	$121.9 bn	$36.1 bn

DATA: BLOOMBERG NEW ENERGY FINANCE
* AS OF END-2009. INCLUDES SMALL HYDROGENERATION, SOLAR, WIND, AND BIOMASS.
** FROM 2005 THROUGH FIRST QUARTER 2010. COMBINES PRIVATE AND PUBLIC SECTOR FUNDING.

China	India	Germany	Spain
The Middle Kingdom is the world's fastest-growing green energy market. China will add 18 gigawatts of wind capacity this year. That's double the amount expected in the U.S.	To lure investment, New Delhi is offering generous subsidies for solar, wind, and biomass. Those are enticing local entrepreneurs to invest billions in green energy projects.	Europe's largest economy has used green subsidies to jump-start its domestic wind and solar industry. National champions like Siemens now dominate the world's eco-industries.	The southern European country's debt crisis has taken the wind out of the sails of its green companies. Cutbacks in government subsidies are pending, which could curtail clean energy investment.
52.5 GW	16.5 GW	36.2 GW	22.4 GW
4.0%	9.0%	29.0%	30.1%
$86.3 bn	$18.3 bn	$25.7 bn	$63.3 bn

Trade

China's Gravitational Pull on Taiwan

- A new pact would deepen Taiwan's ties to its largest trading partner
- "It's vital for us economically. It's a matter of life and death"

China has 1,400 missiles pointed at Taiwan, a stark reminder that Beijing still views the neighboring island as a renegade province that will someday be absorbed, by force if necessary. The two economies, however, have rarely been more in sync. Since Taiwanese President Ma Ying-jeou took office in May 2008, direct air, shipping, and postal links have been established, and mainland tourists now throng Taiwanese cities.

On June 13 the two sides successfully wrapped up a fourth round of negotiations in Beijing on the Economic Cooperation Framework Agreement, aimed at lifting tariffs on either side of the Taiwan Strait. The deal, which Ma's administration has said may be signed this month, would lower tariffs on more than 200 items, including car parts, petrochemicals, and machinery heading from China to Taiwan–and on about 500 items going the opposite way.

Taipei was keen to reach the trade and investment deal with China in order to get its companies the same preferential treatment the mainland now offers 10 Southeast Asian countries. In January a separate free trade pact took effect between China and the Association of Southeast Asian Nations (which excludes Taiwan), lowering tariffs on two-way trade. Beijing is seeking similar trade arrangements with Japan and South Korea.

China is Taiwan's largest investment destination and trading partner, accounting for 40% of its exports. That export market will be placed at risk if Taiwan doesn't get its own trade pact with China. "It's vital for us economically. It's a matter of life and death," says Philip Yang, a political science professor at National Taiwan University in Taipei.

For its part, China has long used economic incentives, in addition to military threats, to draw Taiwan closer into its embrace. "The economic track and political track are separate," says Liu Bih-rong, a professor of political science at Soochow University in Taipei. "The communists in China may hope economic links will lead to political negotiation, but in Taiwan the majority don't want to move that fast."

Taiwanese leader Ma will need to move cautiously as he tries to improve relations with China. The opposition Democratic People's Party has accused the president of selling out to China and has called for a June 26 protest rally, claiming that small and medium-sized businesses will get hurt by the pact.
—Frederik Balfour

The bottom line *China hopes to integrate its massive economy with Taiwan's to such an extent that political unification will be inevitable.*



Taiwan's Ma wants a trade deal with China but faces critics at home

CHI CHIH-HSIANG/AFP/GETTY IMAGES

Amity Shlaes

Lithium Den: Will Afghanistan Get Hooked on a New Narcotic?

Now those Afghan tribes really have something to fight over—other than poppy plants, that is. In case you haven't heard, an estimated $1 trillion in untapped natural resources (iron, copper, gold, and lithium, among others) has been discovered in impoverished Afghanistan. That may seem like a stroke of luck for a country desperately in need of one. However, the research about resource wealth in the post-World War II period suggests that it's actually a curse, unless Afghanistan can do two things. One is incorporate property rights into any new governance structures. The other is to emulate another resource-rich country, Botswana. (More about that later.)

First, the gloomy record. In case after case, the presence of natural resource wealth in a country has fostered political instability and, paradoxically, slower economic growth (page 11). Russia's revenue from oil gave Vladimir Putin the power he needed to take the country halfway back to Stalinism. Zimbabwe's farmland, platinum, gold, coal, and cotton enabled Robert Mugabe to tyrannize that land for decades. In Nigeria, the impact of $1.6 trillion in oil cash over time has been pollution and poverty, along with the black-hooded Movement for the Emancipation of the Niger River Delta (MEND), the creepy guerrilla group that patrols the delta, kidnapping and sabotaging. Diamonds buried in Sierra Leone's hills didn't exactly bring it peaceful prosperity in the 1990s, as we saw in the 2006 film *Blood Diamond*.

Oil wealth makes countries less friendly to entrepreneurs and less hospitable to the U.S. Groundbreaking analysis years ago by economist Jeffrey Sachs, now the director of Columbia University's Earth Institute, represented the first non-Marxist characterization of natural resources as a burden. Scholars earlier identified a narrower version of that malady, Dutch Disease. This is the phenomenon whereby sales of oil or another natural resource harden the national currency, worsening trade for other export sectors and thereby killing them off.



Uyuni Salt Flat, Bolivia: Afghanistan's lithium deposits may rival those of this top producer

Some countries escape the resource dilemma. One way is where the rule of law generally, and property rights specifically, are already well established when large deposits of natural resources are discovered. The U.K. survived, and benefited, following discoveries of North Sea oil in the 1970s. Canada thrived after its discoveries of resource wealth. The cause of a nation's continued stability seems to be property rights. It matters less who owns the resources—governments, companies, or both—than that those rights are clear and respected.

Which brings us back to Botswana, which, like Afghanistan, has tribes, and was fragile when it gained independence. It's also a land rich in diamonds. Over time, and with many twists and turns, Botswana resisted permanent nationalization of its precious gem wealth. Instead it created Debswana, a profit-share agreement with the diamond company De Beers.

At the same time, the government committed to fight corruption and enforce the rule of law. Both the people of Botswana and company shareholders benefited. A nonprofit group, the Property Rights Alliance, ranks Botswana 44th in the world in property rights among nations, whereas Nigeria is 109th and Zimbabwe ranks 121st. Infant mortality in Botswana has dropped to 26 per thousand in 2008 from 118 in 1960. That compares with less dramatic drops to 62 from 97 in neighboring Zimbabwe and 96 from 157 in oil-rich Nigeria.

"Botswana's post-colonial leadership, particularly Seretse Khama and Quett Masire, and also its major economic elites, were committed to democracy, economic development, secure property rights, and fairly orthodox macroeconomic policies," says Daron Acemoglu, the economist at the Massachusetts Institute of Technology who first called attention to Botswana's achievement.

The takeaways for Afghanistan are controversial. The first is that a functioning and representative government is necessary. To skip town after overseeing the establishment of a loose federation of tribes, which is the U.S. impulse, is to guarantee that any "backbone" becomes a bone of contention instead.

Rule of law and good leadership at the outset (right now) are likewise crucial. Property rights are primary, not secondary. It matters less who owns something than that the rights of ownership are clear. Lastly, citizens must know they may claim a share of some form in the mineral wealth, currently or in the future.

Marketing such ideas is going to be next to impossible, especially after the BP disaster. Still, a positive alternative to the Botswana property rights model is hard to imagine. If Afghanistan and its neighbors made war over resources above the ground, why should resources below promise a different outcome? Ⓑ

NOAH FRIEDMAN-RUDO SKY BLOOMBERG

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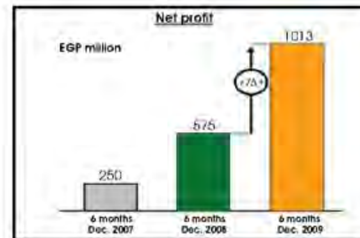
NATIONAL BANK OF EGYPT

National Bank of Egypt net profit exceeds One Billion Egyptian pounds during the first half of fiscal year 2009/2010

The results of National Bank of Egypt (NBE) during the first half of the fiscal year 2009/2010 show unprecedented performance, reflecting the high degree of confidence enjoyed by the National Bank of Egypt in the Egyptian market.

Net profit of EGP 1,013 billion:

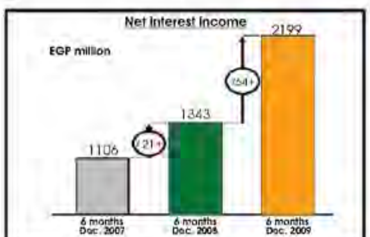
NBE net profit in H1 2009-2010 reached EGP 1.013 billion, with an increase of EGP 438 million representing 76% year over year (y-o-y) growth.



Period	December 2007	December 2008	December 2009
Net profit	EGP 250m	EGP 575m	EGP 1013m

Net interest income of EGP 2.2 billion:

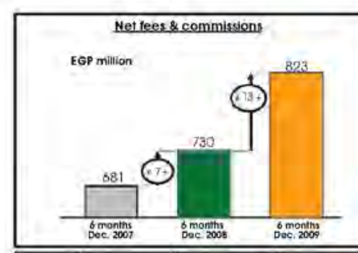
Net interest income grew by EGP 856 million in H1 2009/2010 to reach EGP 2.2 billion, with an increase of 64% y-o-y in comparison with 21% growth in the previous year.



Period	December 2007	December 2008	December 2009
Net Revenue	EGP 1106m	EGP 1343m	EGP 2199m

Net fees & commissions of EGP 823 million:

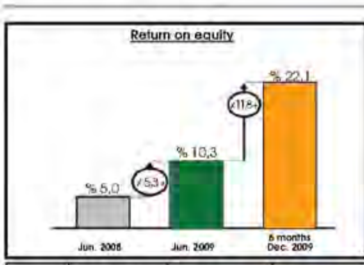
As a result of the active role that NBE played during that period to support international trade, Net fees and commissions grew by EGP 93 million in H1 2009-2010 to EGP 823 million.



Period	December 2007	December 2008	December 2009
Net fees & Commission	EGP 681m	EGP 730m	EGP 823m

Over 22% return on equity:

Return on equity doubled to 22.1% annually in comparison with 10.3% in FY 2008-2009 and 5% in FY 2007-2008.



Period	June 2008	June 2009	December 2009
on equity	% 5.0	% 10.3	% 22.1

Total assets of EGP 271 billion:

Total assets grew by 5% to EGP 271 billion as of Dec 2009.



Period	June 2008	June 2009	December 2009
Total assets	EGP 225b	EGP 259b	EGP 271b

10

PERCENT

The decline in housing starts in May, the biggest drop since the depths of the financial crisis in March of 2009.

DATA: COMMERCE DEPT.

Infrastructure

A Beautiful Game and Really Ugly Traffic Jams



▸ South Africans prefer their cars to new buses and trains

▸ "The onus is on the spectators to leave their cars at home"

South Africa invested in hundreds of buses and refurbished trains to ease traffic congestion during the month-long World Cup, which has attracted an influx of hundreds of thousands of global tourists. Trouble is, many middle-class South Africans rushing to soccer stadiums prefer using their cars. The result: traffic snarl-ups so massive that fans have struggled to get to their matches on time–or at all.

World Cup planners overlooked the fact that wealthier South Africans typically steer clear of poorly maintained minibus taxis and trains where they are easy targets for criminals. The 43 billion rand ($5.7 billion) the government has spent on infrastructure and security to prepare for the world's most-watched sporting event has done little to change that.

"Old habits die hard," says Tony-Twine, an economist at Johannesburg-based advisory service Econometrix. "Public transport is used by poor people and is not a feature of middle-class life, whereas attendance at these games is. Persuading people to use public transport is not an idea you sell in a weekend."

The World Cup is the world's most-watched sporting event, with organizers expecting a TV audience of 500 million viewers. In the southern city of Port Elizabeth, however, at least 8,000 seats, or 20 percent of more than 39,000 sold for the June 12 match between South Korea and Greece, were empty, prompting world soccer's governing body, FIFA, to probe whether transport glitches caused fans to miss the game. The day before, the 22-mile drive from the 88,460-seat Soccer City stadium in Soweto to the wealthy neighborhood of Sandton took up to four hours following the opening match between South Africa and Mexico.

"The challenge here is the number of cars that are being brought near to the stadium," Richard Mkhondo, spokesman for the local organizing committee, told reporters on June 15. "The traffic flow and management system is being improved, but the onus is on the spectators to leave their cars at home."

South Africans may be averse to using buses because they don't trust the drivers. About 500,000 accidents occur on South Africa's roads each year, claiming the lives of more than 9,600 people, according to data published on the Transport Dept.'s website.

Some foreign fans relying on the public transportation system to get them to games say the locals need to wise up. "The logistics are very good," said Frantisek Slovak, 39, a computer salesman from Bratislava, Slovakia. "We are very surprised. We were here two years ago and nothing looked ready."
—Mike Cohen

The bottom line *Middle-class South Africans' aversion to using public transport has created big traffic snarls at the World Cup.*

Tom Keene's EconoChat

Alan Mulally, chief executive officer of Ford, talks about the future of U.S. manufacturing

I get letters from all over America, saying we have to make goods. Do you buy that idea?
Absolutely. Manufacturing is the foundation for economic development, and the answer for energy independence and environmental sustainability. You look at manufacturing in the U.S. and it's nearly 12 percent of gross domestic product and represents 12 million jobs. Seventy percent of all the country's research and development is associated with manufacturing. It's not just assembling and component fabrication. The U.S. is doing system solutions and the highest level of engineering work.

Is labor participating in what appears to be a manufacturing renaissance in America?
Not only are they participating, but they're helping to lead it. I can't say enough about the partnership we have with the UAW. The transformational agreement that we did together is now allowing us to convert truck plants to car plants and make the best vehicles in the world right here in America.

What's the outlook for the auto industry this year. When do we get back to sales of 16 million units a year?
Well, I think it's going to be a little slower than in the past. The economy is recovering, but we've gone down to a low of 10.6 million. Our guidance right now is 11.5 million to 12.5 million in the U.S. for this year and then maybe over 14 million in 2011. We're recovering–consumers are coming back. Ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

FROM LEFT: JOE KLAMAR/AFP/GETTY IMAGES; ANDREW HARRER/BLOOMBERG

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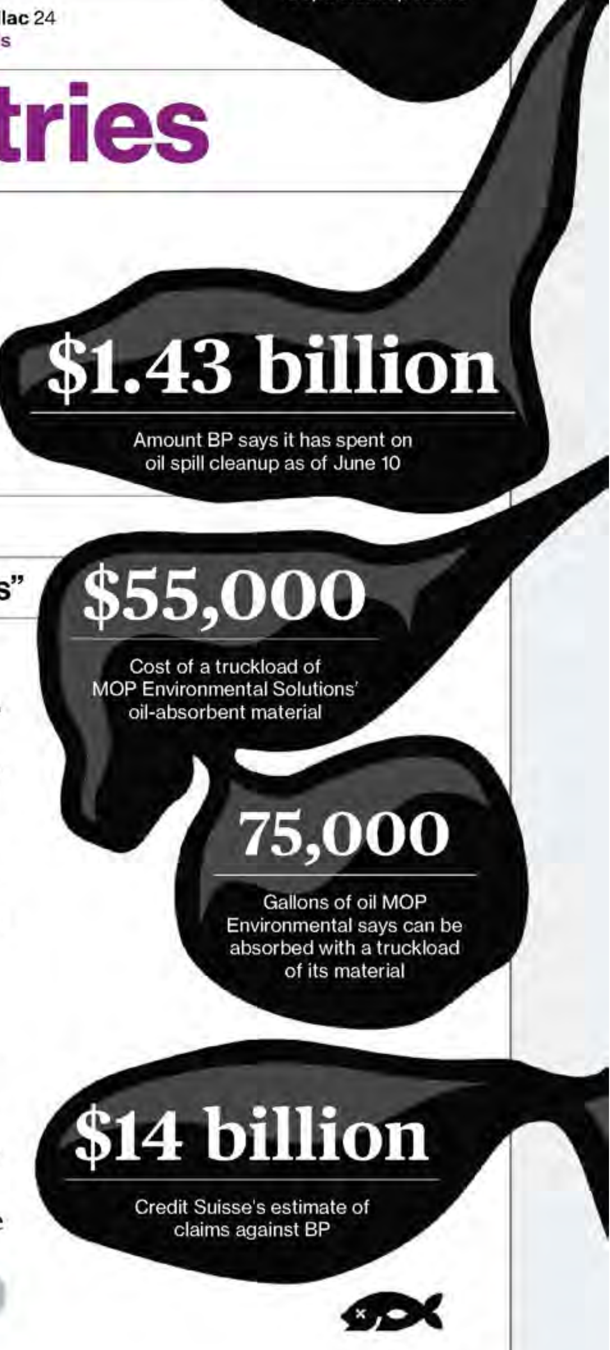


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Cleaning Up from The Cleanup



▸ While the spill slams many Gulf businesses, some may profit

▸ "My phone is ringing pretty steady; everybody is looking for boats"

Michigan's depressed economy nearly toppled Grand Rapids-based awning maker **Prestige Products.** Then in April, the company's fortunes changed dramatically when executive Brian Rickel got a phone call from an old contact at **BP.** It was 10 days after BP's Deepwater Horizon rig had exploded, and BP needed help containing the gush of oil. Six weeks later, Prestige has rented a factory, filled it with millions of dollars of new equipment, and hired 74 workers (it employed only six as of April). Using material similar to the vinyl in awnings, Prestige is churning out 12,000 feet a day of booms, the floating barriers that help contain oil slicks. Prestige hopes to double its output—if it can hire 50 additional workers.

"We're in Michigan. The economy has been horrible for everybody here," Rickel said in an interview. "But the expertise is here and we cashed in on it."

The spill in the Gulf of Mexico will inflict billions of dollars' worth of damage on the economies of Louisiana, Alabama, Mississippi, and Florida by destroying fisheries, halting oil drilling, and scaring off tourists. But for scores of businesses—from small fry like Prestige to big operators like construction giant **Fluor**—there's money to be made in the aftermath of the worst oil spill in U.S. history.

It's a dichotomy present across the Gulf region. A sign on a shuttered seafood shop in Grand Isle, La., blames BP and President Barack Obama for its woes. Nearby motels and repair shops display Help Wanted signs for maids and mechanics to help with the crush of cleanup activity. Local caterers are aggressively advertising, trying to persuade BP to hire them to feed the cleanup crews gathering on the coast.

Rene Vegas, owner of **Bridge**

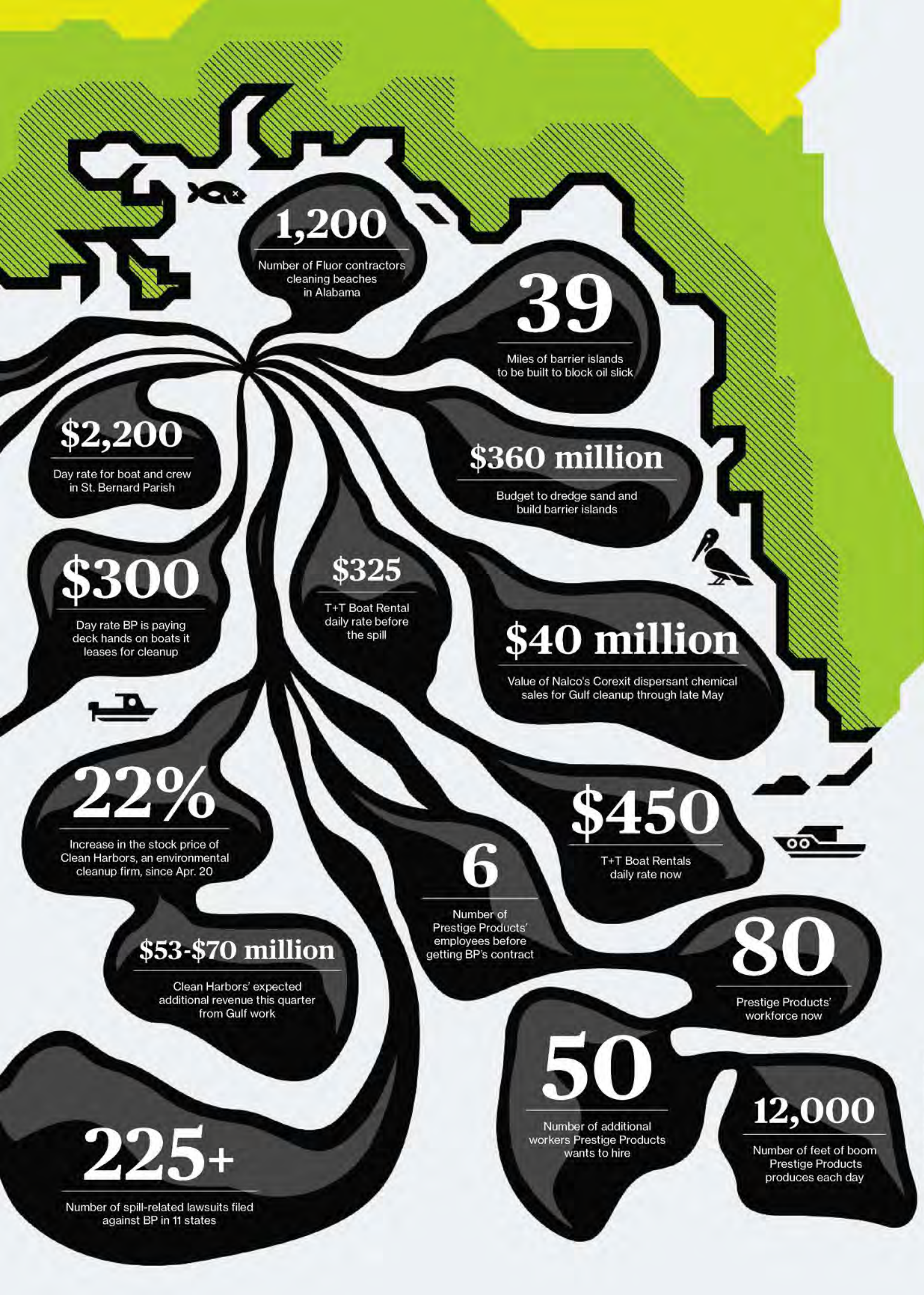


ILLUSTRATION BY ALWAYS WITH HONOR

Companies&Industries

Side Cabins & Marina, also in Grand Isle, says his summer sport fishing season is lost thanks to the fast-expanding oil slick. So, like many area businessmen, he's shifting his focus from tourism to the cleanup effort. Vegas has begun stocking rubber boots, hard hats, and ropes to sell to cleanup crews.

Troy Petrovich, co-owner of **T+T Boat Rentals** in Buras, La., has seen demand for his marine-related services spike. Before the spill, "I kept calling, putting out more phone calls" in search of oil company customers, says Petrovich. "Now my phone is ringing pretty steady; everybody is looking for boats." T+T has rented out all 10 of its boats to oil companies and raised the daily rate to $450 from $325.

Plenty of other businesses aren't waiting for business to come to them. Shortly after the spill began, **MOP Environmental Solutions**, a Bath (N.H)-based maker of a substance it claims absorbs up to 30 times its weight in oil, sent four employees to the Gulf to conduct demonstrations for cleanup officials. The MOP workers came armed with fish tanks, oil, water, and the absorbing material in the trunks of their cars. Some of the company's shareholders hired a local pilot to fly around the region with a banner reading, "We mop up oil." After weeks of being pestered, BP purchased its first three truckloads of the oil-absorbent material for $155,000, says MOP President Charles Diamond.

The company didn't have to wait as long to get a full hearing as actor Kevin Costner. Costner's company, **Ocean Therapy Solutions**, uses barge-based turbines to separate water from oil. He first demonstrated the centrifuges to BP officials at a technology conference 10 years ago, but wasn't given the go-ahead to test the gear in open water until earlier this month. Now Ocean Therapy says it has sold 32 of the centrifuges to BP.

Another notable beneficiary of the cleanup has been **Nalco Holding.** More than 1 million gallons of Nalco's chemical dispersant Corexit, which breaks up oil slicks, have been used in the Gulf. The chemical company sold $40 million of Corexit to BP for the cleanup effort through the week of May 15, according to spokesman Charlie Pajor.

Some faraway businesses are profiting from producing or deploying equipment to get rid of the oil residue. The Slickbar Products division of Finland's **Lamor** sent employees to Mississippi to help install its skimmers, which collect oil from the water, onto shrimp boats. Its oil boom plant in Seymour, Conn., is operating at a pace not seen since the Exxon Valdez spill in 1989. Slickbar has made more booms in the past month than it had in the previous 12 months, says CEO Stephen Reilly.



A worker at Prestige Products readies booms for the cleanup

There's plenty of cleanup activity on land as well. Fluor, the big construction company, has a contract to supply BP with workers to clean up tar on Alabama and Florida beaches. So far it has hired 1,200 workers in Alabama and 2,400 in Florida, all of them off unemployment rolls in those states, says spokesman Brian Mershon. Fluor plans to increase its Florida workforce to 4,100.

The cleanup rush isn't generating just blue-collar work. The Pensacola (Fla.) law firm of Levin Papantonio Thomas Mitchell Echsner Rafferty & Proctor has hired an airplane to fly a banner over beaches reading "Prosecute BP" and is offering free claims evaluations. "There are probably hundreds of lawyers who are working to generate claims on the BP spill," says Fredric Levin, a partner in the firm. Washington's K Street crowd also stands to benefit as federal regulators crack down on drillers. **Transocean**, owner of the troubled Deepwater Horizon rig, has hired former congressman Bill Brewster's lobbying firm, Capitol Hill Consulting Group, to represent its interests, according to a regulatory filing on May 10. The Shaw Group, which has a $360 million contract to build barrier islands along the Gulf Coast, is hiring staffers to count birds on nearby islands and map shipwrecks.

Litigation or legislative changes may generate years of billings. For now, many small businesses in the affected area are taking advantage of the spill work while they can. Marina owner Vegas, for one, says he has as many as 60 BP employees and contractors staying at his marina, which normally caters to sport fishermen and beachgoing families. "The motel is booked, the motel is doing fine," he said. "But when they leave in January or December, we're in trouble." —*Mark Drajem and Katarzyna Klimasinska*

The bottom line *Although the BP spill is disrupting tourism and fishing activities along the Gulf, it has been a short-term boon to many businesses.*

Quoted

"Innovation has winners and losers. We didn't tax car companies to protect horses. The whole thing is absurd."

—Gary Shapiro, president of the Consumer Electronics Assn., on the Federal Trade Commission's proposal to tax sales of consumer electronics and broadcast advertising to help ailing newspapers



Labor Unions

Givebacks: The New UAW Chief's Challenge

▸ Bob King, an electrician with a law degree, inherits a shrunken union

▸ "There will be tremendous pressure ... to roll back concessions"

The United Auto Workers gave up thousands of jobs and benefits worth billions of dollars to help save the U.S. auto industry. The legacy of its new leader, Bob King, will rest on how workers are rewarded during the recovery. King, who defeated Gary Walkowicz 2,115 to 75 on June 16 to succeed President Ron Gettelfinger, takes over a union that has declined to 355,000 members from 1.5 million in 1979.

General Motors posted a net profit and **Chrysler Group** made money on an operating basis in the first quarter, less than a year after each emerged from bankruptcy. The union helped persuade President Barack Obama to provide an $85 billion taxpayer bailout to those car manufacturers and made concessions to put their labor costs on par with foreign automakers' U.S. plants. King supported the moves.

"There will be tremendous pressure on him to roll back the concessions," says Gary N. Chaison, a labor professor at Clark University in Worcester, Mass.

King, the son of a former **Ford Motor** industrial relations director, has been painted by challengers in the union as going too easy on that company. More than 70 percent of Ford workers rejected additional concessions in November that King endorsed. Still, King's fans say he's no pushover. He led a strike at **Johnson Controls** in 2002 in which he persuaded the auto parts supplier to sign a neutrality agreement allowing the union to organize its other U.S. plants. Ford also said it wouldn't object to the UAW representing workers at Johnson, a Ford supplier. The UAW signed up 25,000 auto parts workers that year, according to labor professor Harley Shaiken of the University of California at Berkeley.

—Keith Naughton and Jeff Green

The bottom line *Some critics say the new UAW chief is too soft on automakers, though he's proven his toughness in past negotiations.*

Obituary

Jimmy Dean



1928-2010

After success as a country singer and TV host, the entrepreneur launched an American breakfast favorite

Jimmy Dean, who died on June 13 at age 81, liked to say he had ad-libbed his life. That was partly true: He was at various times a country singer, a television host, and, of course, an entrepreneur who relentlessly promoted his multimillion-dollar brand of sausages. ("I'm Jimmy Dean and I'd like you to try my Pure Pork Sausages.") He could be charming and witty. He also had a shrewd instinct for opportunity and, to some, an unexpected prickliness when he thought he had been wronged.

Dean was raised by his mother on an impoverished farm outside the West Texas town of Plainview and later would say that the fear of poverty motivated him more than anything else. He dropped out of high school and joined the military, where he entertained servicemen at a Washington (D.C.) base. After he was discharged in 1948, he got a band together, the Texas Wildcats, and began playing in local clubs.

Soon he was the star of a popular syndicated variety show, and by 1957, he was on CBS, hosting *The Jimmy Dean Show*. Four years later, his ballad about a heroic coal miner, *Big Bad John*, won a Grammy; Dean said he wrote the song in 90 minutes on a plane to Nashville.

In the mid-1960s, he bought a pig farm in Plainview and later started the Jimmy Dean Meat Co. with his brother, Don. Jimmy was always looking for ways to protect himself from the vagaries of the entertainment business. The company became profitable in just six months, and the brothers later fought over who would control it. Jimmy prevailed; he and Don never reconciled. During an appearance on *The Mike Douglas Show* in 1977, Jimmy read a poem that concluded: "When you make your brother a partner, you start ills for which there are no cures. You'll find he'll develop eye trouble, and he can't tell his money from yours."

Dean sold the company to the conglomerate that would become Sara Lee in 1984, and for almost two decades he happily pitched his sausage on TV. Then, in 2003, Sara Lee dumped him as spokesman, saying that the brand was moving in a different direction. Dean was livid. He sold all of his stock except one share, which he held onto so he could attend the annual meetings. In an interview with bankrate.com in 2004, he said: "I would not come back if they asked me. I don't use the product anymore." Daryl Gormley, a Sara Lee executive, said in an e-mail: "We have always held Mr. Dean in the highest regard. His charm and charisma were unmatched."

Dean spent the last years of his life with his second wife, Donna Meade Dean, on their 200-acre estate near Richmond, Va. When he found out in February that he had been elected to the Country Music Hall of Fame, he joked: "I thought I was already in there."

—Susan Berfield

Early Life ▸ **Abandoned by father** ▸ **High school dropout**

Motivation ▸ **Frequently said a fear of poverty drove him**

Legacy ▸ **A breakfast brand with $663 million in sales**



OPPOSITE, FROM TOP: PHOTOGRAPH BY JON LOWENSTEIN FOR BLOOMBERG BUSINESSWEEK; DANIEL ACKER/BLOOMBERG. THIS PAGE, FROM TOP: SHEL HERSHORN/HULTON ARCHIVE/GETTY IMAGES; STOCKFOOD

Companies&Industries



What's holding back energy R&D in the U.S. page 29 ▶

Autos

Cadillac Starts Putting on the Ritz

▶ GM looks to the hotel chain in a bid to restore Caddy's luster

▶ For today's luxury car buyer, "You no longer need a geezer-mobile"

Last year, with its corporate survival on the line, **General Motors** still managed to spend $354 million on marketing for its Cadillac division, according to industry estimates–more than any other luxury car maker in the U.S. The branding campaign was largely ineffective: In 2009 Cadillac sold all of 109,092 vehicles, its worst year since 1953. The brand's product lineup needs refreshing, the average age of its buyers is a less-than-youthful 62 (13 years older than typical **BMW** owners), and Cadillac hasn't been the top-selling luxury auto brand in the U.S. since 1997.

It's hard to see GM Chief Executive Officer Edward E. Whitacre Jr. pulling off a full-fledged recovery at his company without far better performance at the company's luxury car division, which sells the Cadillac CTS sedan, Escalade SUV, and other models. "We know we've got a lot of work to do on the product side, the marketing side, and the customer service side," says Kurt McNeil, Cadillac's U.S. vice-president of sales and service. "We think we do pretty well, but ... we have to do better."

What to do? Sell like the Ritz. In its effort to reconnect with upscale customers, GM has brought in trainers from **Marriott International**'s Ritz-Carlton Hotel chain to show Cadillac dealers how to create a consistent sales experience across the U.S., similar to what customers expect at Ritz-Carlton Hotels, says Jeff Hargett, corporate director of learning and content delivery at the Ritz-Carlton Leadership Center in Chevy Chase, Md. So far he's led nine training sessions in cities from New York to Atlanta to Los Angeles, with more than 2,100 dealership owners and salespeople.

Cadillac has copied Ritz's pocket-size "Credo" cards, which explain how customers should be treated, with a version it is handing out to all company and dealership employees. Ritz employees also have $2,000 that can be used to make up for a bad experience or surprise a guest with a better one, Hargett says. He suggests Cadillac dealers find similar ways to let sales and service people "wow" customers.

So Cadillac service chiefs are now given greater flexibility to extend OnStar subscriptions, provide free maintenance, or even reduce service charges for customers who are unhappy, says Steve Hill, GM's manager of customer care. Gary Grossinger, who owns Grossinger Cadillac in Palatine, Ill., near Chicago, says he gave employees $300 to $500 in "wow" money after learning about the Ritz policy at a presentation to dealers in early June. He recently began phoning customers to gauge their satisfaction.

GM also is trying to garnish the brand image. Cadillac recently removed most references to mass-market icon GM from its Web pages and e-mails. Gaudy showroom displays–inflatable animals, neon letters, balloons to advertise sales–have also been banned, says Ed Peper, Cadillac's general sales manager.

Still, analysts say no image remake can fully succeed until Cadillac comes up with more stylish models that can attract younger buyers. The automaker could gain some traction when it introduces an all-wheel-drive XTS sedan next year and a smaller entry-level Caddy the year after. For now, the company's image will likely remain dinged as it continues churning out land yachts such as its DTS, which researcher Strategic Vision says appeals mainly to buyers in their 70s. Says John Wolkonowicz, an analyst at auto forecaster IHS Global Insight: "You no longer need a geezer-mobile."

—Jeff Green and David Welch

The bottom line *After years of decline, Cadillac is trying to regain its luxury aura. But given its older and less affluent owner base, that's an uphill battle.*

38

PERCENT

Share of Britons (from age 18 to 45) who say they'll skip work to watch the World Cup matches

DATA: YOUGOV SURVEY

Renewable Energy

A Tailwind for Chinese Wind Turbine Makers



▶ Beijing's preference for domestic makers is hampering multinationals

▶ "Some companies will have to leave China in the next five years"

Just five years ago, **General Electric**, Denmark's **Vestas,** and other foreign wind turbine makers controlled 71 percent of China's market. Now that Beijing has supercharged spending on renewable energy, Western companies face increasingly aggressive local rivals. By last year their share had fallen to 14 percent, although sales are still headed upward. "It's a tough market," says Jesus Zaldua, president of **Gamesa China,** a subsidiary of Spain's Gamesa that has four wind turbine factories in the northeast city of Tianjin. "Some companies will have to leave China in the next five years."

Buoyed by $47 billion in stimulus spending earmarked for green energy over two years, China has become the world's fastest-growing market for renewable energy. This year the

FROM TOP: KHUE BUI; ZHOU YOU/COLOR CHINA PHOTO/AP PHOTOS

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mainland is on track to add 18 gigawatts of wind capacity, double what's expected in the U.S., the No. 2 market, according to Bloomberg New Energy Finance.

Vestas, the top foreign player in China, installed turbines with a total capacity of 620 megawatts there last year, New Energy Finance estimates. The biggest mainland company, **Sinovel**, sold turbines with 3,523 Mw of capacity. Sinovel and **Goldwind,** the second-biggest Chinese wind turbine maker, are among the top five global turbine makers, though they sell very little overseas.

Chinese makers have kept costs down by licensing older technology from overseas rivals, including Vestas, Japan's **Mitsubishi,** and others that sell their own turbines in China. While the locals pay royalties, that doesn't come close to making up for the business the foreign companies are losing in China. The country's buy local policy steers most state-financed energy contracts to domestic players. "There's no question preference is given to Chinese companies," says Magued Eldaief, a top **GE Energy** executive who oversaw its Asia Pacific unit.

To get back in the game, foreigners are offering newer technology. **Siemens** this year plans to open an $80 million plant in Shanghai that can produce 3.6 Mw turbines, bigger than any Chinese models. Gamesa plans to build 2 Mw turbines. These cost nearly a third more per Mw than Chinese models do, but they're more reliable, according to Beijing-based renewables consultancy Mint Research. "Competing on cost isn't the way to go. It's about quality," says Jens Tommerup, president of Vestas China. Chinese manufacturers say they are improving quality, and Goldwind plans to introduce higher-output turbines next year.

Still, the foreigners' head start in technology could pay dividends as the Chinese venture abroad. Western bankers, who would likely finance any big projects outside China, tend to have greater faith in U.S. and European turbines because of the companies' years of experience, says Keith Hays, global wind research director at Emerging Energy Research in Barcelona. "For now, the West has an advantage in quality," says Hays. "But the Chinese are catching up fast." *—Mark Scott, with Dexter Roberts and Stuart Biggs*

The bottom line *Foreign wind turbine makers' market share in China has shriveled. Their strong suit is quality, as Chinese rivals expand abroad.*

In brief



Tesla CEO Musk is hoping to raise $178 million in an IPO

Tesla Motors
Turning to Investors For a Boost
Electric car manufacturer Tesla Motors, which has yet to post a profit since it was founded in 2003, plans to sell 11.1 million shares at $14 to $16 each in an initial public offering. The producer of the $109,000 Roadster said it will use proceeds from the estimated $178 million IPO to pay for factories and fund possible acquisitions, according to a Securities & Exchange Commission filing. Existing stockholders, including PayPal founder and Tesla CEO Elon Musk, will sell 1.1 million shares, while Toyota Motor will buy $50 million of stock in a private placement, a spokesperson for Palo Alto (Calif.)-based Tesla said.

Axa
Putting a Piece of Itself on the Block
France's Axa, Europe's No. 2 insurer, is in talks to sell part of its U.K. life insurance unit to Resolution for $4 billion. Resolution, which could double its assets with the deal, plans to fund the purchase through a $3 billion rights offer. The Axa division ranks eighth in U.K. life insurance. Several European insurers are, like Axa, seeking to free up capital in slower-growing markets to fund growth in Asia, where margins are richer.

Starwood
A Tug-of-War Over Extended Stay Hotels
Starwood Capital Group remains intent on acquiring Extended Stay Hotels, despite losing out at a bankruptcy auction on May 27. The winning bid of $3.9 billion came from an alliance of Centerbridge Partners, Paulson & Co., and Blackstone Group. Starwood, which estimates Extended Stay's value at $5.2 billion, claims that the auction's rules chilled the bidding process and is seeking court permission to propose a competing plan to restructure the more than 600-hotel chain.

Nestlé vs. Sara Lee
An International Coffee War Breaks Out
Switzerland's Nestlé has filed a patent infringement lawsuit against Sara Lee in France, where the U.S. company recently introduced coffee capsules that Nestlé says piggyback unfairly on its Nespresso single-serve coffee-making system. Sara Lee introduced L'OR Espresso capsules, compatible with Nespresso machines, in April and has since sold over 12 million; it says the new product meets all legal requirements.

Delta and American Airlines
Fuller Planes and Steeper Prices
Delta Air Lines and American Airlines, the two largest U.S. carriers, are forecasting second-quarter gains of at least 17 percent, using a benchmark for industry revenue, as rising demand buoys fares. After cutting capacity and prices when business fliers stayed put during the recession, big U.S. carriers are again flying fuller planes. US Airways' corporate travel revenue jumped 50 percent in May from a year earlier.



Best Buy
A Second Chance for Used Video Games
Starting in late summer, Best Buy will offer customers the option of exchanging their used video games for gift cards redeemable at its stores. The trade-in plan is an attempt by the consumer-electronics giant to grab sales from rivals GameStop, Wal-Mart Stores, and Target, and reverse its first-quarter decline in gaming merchandise sales. Best Buy will offer the swaps at more than 1,000 of its U.S. stores. Later this year, the company will also introduce touchscreen kiosks that will allow customers to test and preorder games.

Microsoft
How the iPad is Hurting Windows
While iPads continue to sell well and Apple struggles to fill orders for its brand new iPhone 4, Microsoft's failure to deliver a tablet-friendly version of Windows is forcing big computer makers such as Hewlett-Packard and Dell to rely on rival software from Google to help them keep up. Windows 7 is too unwieldy for iPad-like devices and a new version won't come out until the fourth quarter, giving Apple almost a year's head start in the fast-growing market of tablets.

CAA
Keeping Up With a Changing Hollywood
Creative Artists Agency is in discussions with private equity funds Kohlberg Kravis Roberts and TPG Capital about investment in the firm, according to *The New York Times*. The entertainment and sports powerhouse, which represents clients ranging from actress Meryl Streep (below) to British soccer superstar David Beckham, is looking for new sources of capital to expand its business and keep up with Hollywood's ever-changing economy.



MUSK: FRED PROUSER/REUTERS/CORBIS; GAMES: ART DIRECTORS & TRIP/ALAMY; STREEP: ROBYN BECK/AFP/GETTY IMAGES



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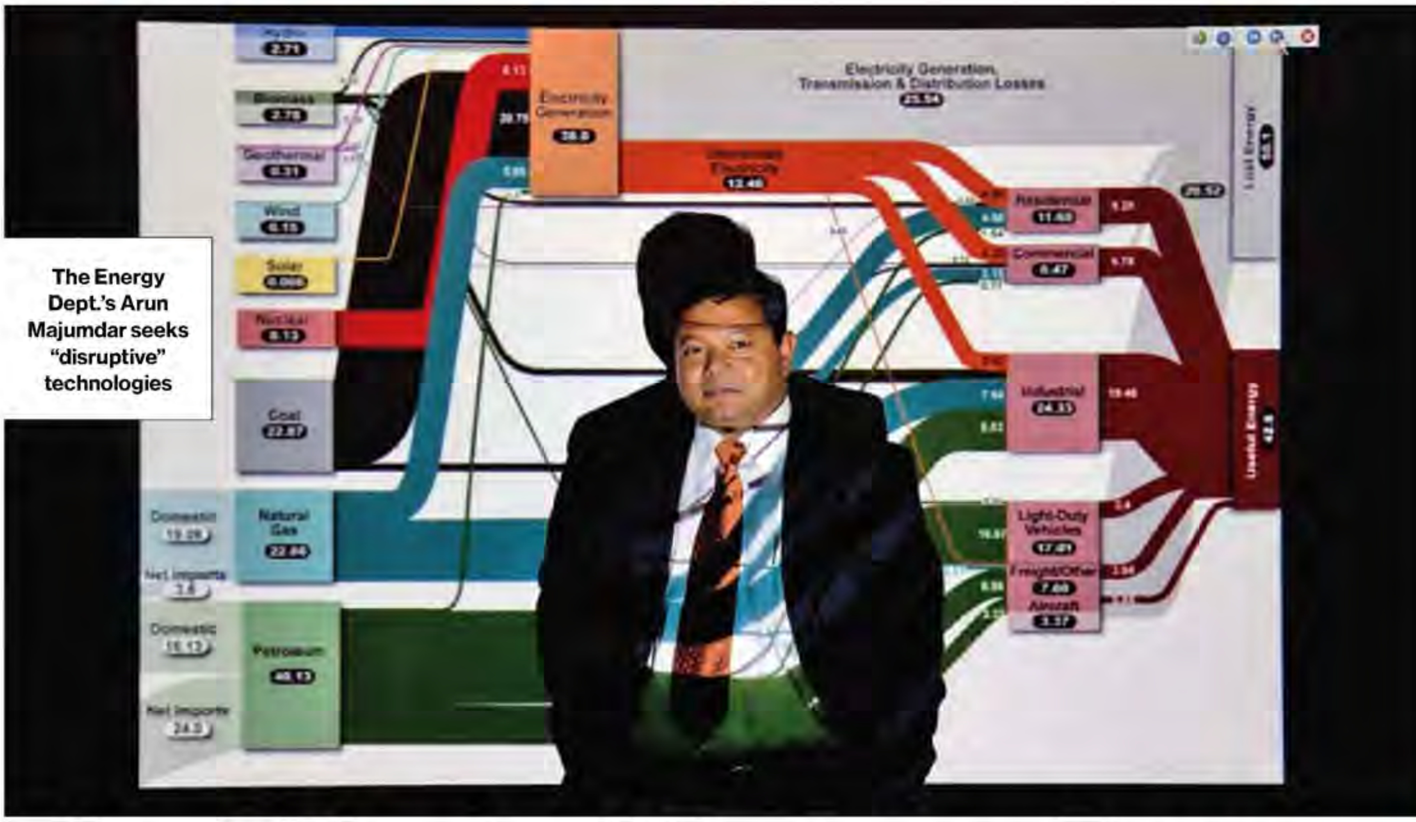
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Politics&Policy



The Energy Dept.'s Arun Majumdar seeks "disruptive" technologies

The Effect of Gamma Rays On U.S. Energy Policy

▶ **R&D neglect is holding back innovative energy sources**

▶ **"I'd rather have the competition inside the U.S. than outside the U.S."**

BP says it's throwing its best people at stopping the Gulf of Mexico oil spill. Nevertheless, it took an outsider–Energy Secretary Steven Chu, who has a Nobel Prize in physics–to come up with the idea of peering inside the malfunctioning blowout preventer with high-energy gamma rays. BP tried Chu's idea–after a few snickers and Incredible Hulk jokes, according to the *Washington Post*–and lo and behold, it worked. The probe was "crucial in helping us understand what is happening inside the BOP [blowout preventer] and informing the approach moving ahead," said Jane Lubchenco, head of the National Oceanic & Atmospheric Administration.

The gamma ray incident is symptomatic of a problem that's bigger than London-based BP: Energy companies worldwide are far less science-oriented than one might expect from an industry that is heavily dependent on technology for safety and profit. In the U.S., energy companies' spending on research, development, and deployment amounts to just 0.3 percent of sales. That's barely more than a tenth what the auto industry spends as a share of sales and is dwarfed by the pharmaceutical industry, which spends nearly 19 percent of sales. (American Petroleum Institute chief economist John Felmy says R&D measures understate his industry's "overall investment for the future.")

Many economists argue that government needs to step in when the private sector isn't providing the socially optimal amount of something like research. But government R&D spending on energy has been scarce, too. It was less than 0.03 percent of U.S. gross domestic product as of 2007, about one-third the share in Japan. The dearth of investment in energy R&D helps explain why the world is still getting its energy by punching holes in the sea floor rather than from safer, renewable sources such as the sun and the wind.

In his Oval Office speech on the Gulf spill on June 15, President Barack Obama cited a rapid boost in energy R&D as one of several ideas that "have merit and deserve a fair hearing in the months ahead." That was a paler endorsement than some boosters hoped for. On June 11, the American Energy Innovation Council called for a gradual increase to $16 billion in annual federal R&D energy spending, from around ➡

PHOTOGRAPH BY KHUE BUI FOR BLOOMBERG BUSINESSWEEK

$5 billion now. The seven-member council includes **Microsoft** Chairman Bill Gates, **General Electric** Chief Executive Officer Jeffrey Immelt, and Silicon Valley venture capitalist John Doerr.

The drive for more energy R&D is up against formidable obstacles, starting with the budget deficit. Representative Ralph Hall, the ranking Republican on the House Science & Technology Committee, tried in May to cut about $40 billion from the $86 billion sought by House Democrats for the America COMPETES Act, which funds federal research and math and science education. "We must be mindful of our spending if America is to continue to compete globally," Hall said then. The House eventually voted to reauthorize the act without Hall's cuts, while the Senate hasn't yet acted. Even if Congress agrees to authorize the full $86 billion, funding could still be cut in the appropriations process.

Money isn't the only problem. On the right, many Republicans say the federal government should be involved only in basic science, not steps toward commercialization. On the left, many Democrats hope to kick-start research and investment in green energy via measures such as carbon caps that would make coal and oil more expensive.

Hanging in the balance are initiatives such as ARPA-E, a 20-employee Energy Dept. program that funds what Director Arun Majumdar calls "really high-risk, high-reward, disruptive technologies." ARPA-E is modeled on DARPA, the Pentagon's Defense Advanced Research Projects Agency, which helped launch the Internet and the global positioning satellite system. Like DARPA, the Energy program is free from civil service hiring rules, so it can bring in top scientists and engineers for short stints. It began operations last year with a two-year allocation of $400 million in stimulus funds. The Obama Administration is seeking $300 million for ARPA-E for the fiscal year beginning Oct. 1.

Defying bureaucratic convention, ARPA-E is funding an unorthodox technique for producing fuel from plant matter even though it competes with another project of the Energy Dept., the Joint BioEnergy Institute. "That's the kind of environment we want," Majumdar said in a June 14 interview. "I'd rather have the competition inside the U.S. than outside the U.S."

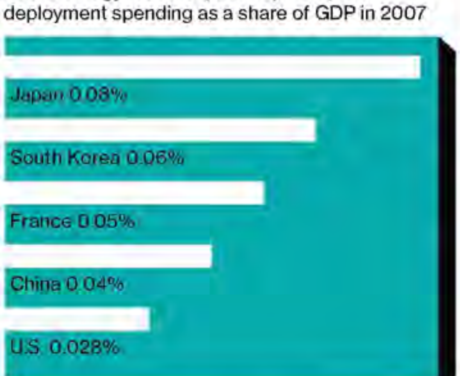
What looks like fruitful competition to Majumdar can look like wasteful redundancy to a Congress that's worried about deficits. He says that's a problem. "Frankly we haven't done a good enough job of explaining what we're about. It's a new model."

The American Energy Innovation Council argues that ARPA-E merits $1 billion a year. Majumdar says he'd be happy just getting the requested $300 million given the big budget deficit. On the other hand, Energy's Chu testified last year that China is spending $9 billion a month on clean energy investments. Says Energy Under Secretary Kristina Johnson: "We're competing with some very fierce competitors that are throwing everything they have behind being successful in this clean energy economy." *—Peter Coy*

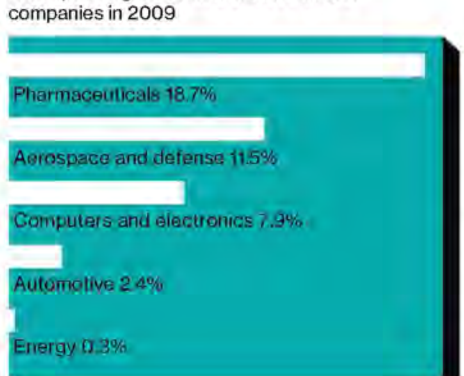
The bottom line *Lack of R&D is limiting development of new energy technologies, and prospects for a big increase remain cloudy.*

The U.S. Government Lags in Energy Research—and So Do Energy Companies

Public energy research, development, and deployment spending as a share of GDP in 2007



R&D spending as a share of sales at U.S. companies in 2009



DATA: AMERICAN ENERGY INNOVATION COUNCIL



As Obama visited the Gulf Coast, BP geared up in Washington

FROM LEFT: MANDEL NGAN/AFP/GETTY IMAGES; KEVIN LAMARQUE/REUTERS

The Influencers

Outrage Grows. So Does BP's Beltway Crew

- Its hired guns are Washington insiders adept at crisis management
- "The issues of their own credibility have damaged them so much"

President Barack Obama used the occasion of his first Oval Office address on June 15 to order **BP** to set aside "whatever resources are required" to compensate workers and business owners harmed by the Gulf of Mexico oil spill. A day later, at the White House for a private tongue-lashing, BP executives did just that, putting $20 billion in escrow and canceling payment of a dividend to shareholders. Meanwhile, Congress prepared to go on the attack, with BP Chief Executive Officer Tony Hayward set to face a verbal drubbing on June 17 from a House panel over charges that his company cut corners in pursuit of profits.

BP is maintaining a careful public equilibrium while oil continues to spill into the Gulf—executives have not gone into hiding, nor have they been defensive as more and more demands are made on the company's purse. Still, they aren't taking the political piling-on



lightly. Coordinating the nuanced approach is a crisis-management team, assembled over the last two months, of high-priced Washington insiders.

Orchestrating the response is the **Brunswick Group**, whose Washington managing partner, Hilary Rosen, has connections throughout the city as the former head of the Recording Industry Association of America and from previous jobs that include working for Senator Dianne Feinstein, a California Democrat. To help massage the press, Brunswick has retained John Feehery, who served as an aide to former House Speaker Dennis Hastert. Other recent hires include Alex Castellanos, an adviser to GOP Presidential campaigns, who comes aboard with his own media and advertising firm, **Purple Strategies**. **WilmerHale**, a law and public policy firm populated by top officials from President Bill Clinton's Administration, is helping contend with multiple legal issues and congressional investigations. To help BP fight the war against viral innuendo, **Ogilvy Public Relations Worldwide** is advising on digital media such as **Facebook** and **Twitter**. Brunswick, Ogilvy, Rosen, Feehery, and Castellanos all declined to comment. Officials at WilmerHale didn't respond to requests for comment.

The experts talk daily to plot strategy and dissect the day's events. In prepping Hayward for his hearing, says one adviser, the basic message was: Don't say anything you don't know to be true. At the June 16 White House meeting, company officials were accompanied by WilmerHale partner Jamie Gorelick, a former deputy attorney general under Clinton, and Michele Davis, a Brunswick partner who was former Treasury Secretary Henry M. Paulson Jr.'s spokeswoman.

Senator Jeff Sessions (R-Ala.), whose state's coastline is being destroyed, says none of this counsel is doing much good. "I don't think their repeated statements that they are moving to efficiently compensate people who have suffered damages and to protect the beaches and estuaries has been perceived as very credible," he says. BP is getting much the same reception all over town. "The issues of their own credibility have damaged them so much that the things they are saying ... are just not remotely resonating with people," says Jack Quinn, the former White House counsel under Clinton who founded Quinn Gillespie & Associates, a lobbying firm. Quinn is not doing any BP work.

Even before the spill, BP had some of the city's top fixers on retainer, including Ken Duberstein, a former chief of staff to President Ronald Reagan, and Tony Podesta, brother of John Podesta, who ran Obama's transition team. All this talent is pricey: BP paid Duberstein $400,000 in 2009 and $100,000 so far this year, according to lobbying reports. Superlawyers such as WilmerHale's Gorelick bill between $900 and $1,100 an hour, says law firm consultant Peter Zeughauser.

There is a danger that the BP public-relations effort, highlighted by TV ads that promise the company "will make this right," may make matters worse. Obama pilloried the company in a June 4 speech for running what he called a $50 million image campaign while the leak goes unplugged. A push to use Twitter isn't catching on, either. While posts by Hayward and other executives at @BP_America have close to 15,000 subscribers, that feed is dwarfed by tweets mocking the company at @BPGlobalPR, which has more than 167,000 followers.
—*Kristin Jensen and Jim Snyder*

The bottom line *BP's hiring binge of lawyers, lobbyists, and media experts to help it deal with angry demands from Washington may not be doing it much good.*

Electoral Reform

The Money Behind A California Revolt



▸ How Schwarzenegger and business leaders bankrolled the Prop 14 win

▸ "It makes me sick, this state is so dysfunctional."

Arnold Schwarzenegger ends his seven-year run as California's governor with a 23 percent approval rating and a $19.1 billion budget deficit. When the former action-movie hero heads out of Sacramento in January for good, he can take some solace from the fact that he orchestrated an effective alliance with business leaders to push through a ballot initiative that just might change the way the state is governed.

Californians voted enthusiastically on June 8 to approve Proposition 14, a measure that will replace primaries with wide-open elections by 2011. Schwarzenegger's political action committee, plus some prominent California executives, raised $4.6 million to promote the referendum. What united most of them was a distaste for the vintage California brand of partisan politics that ultimately doomed the governor's efforts to cap government spending, something that might have averted the state's fiscal crisis.

"It makes me sick, this state is so dysfunctional," says Los Angeles real estate developer Brian Harvey, who contributed $100,000 to support the measure. "I think this will attract more moderate candidates." Other backers such as **Netflix** Chief Executive Officer Reed Hastings ($257,000), **Hewlett-Packard** ($100,000), and the California Chamber of Commerce ($720,000) hope the new system, in which the top two candidates chosen by all registered voters would face off in general

Is Dell going private? page 37 ▶



elections, will bring more moderation to California politics. "I'm a lifelong Democrat, but I'm a centrist," says Los Angeles philanthropist Eli Broad, who gave $100,000 to the Prop 14 cause. "Because of labor interests on the left and anti-tax folks on the extreme right, nothing gets done."

Adam Mendelsohn, the Republican consultant tapped by the governor to run the ballot initiative campaign, says he had anticipated spending as much as $15 million to win. Instead, he supervised a low-key push with radio ads asking voters if they were happy with the status quo.

Proposition 14 had been denounced by labor groups and the state's six recognized political parties, some of which may mount a legal challenge. "The whole purpose of this is so the Chamber of Commerce can try to get business-friendly Democrats elected, who don't support global warming, environmental legislation, or labor protection bills," says John Burton, head of the state's Democratic Party. "This isn't going to change anything."

Schwarzenegger's political action committee also financed and won a 2008 anti-gerrymandering referendum that took the authority to determine the boundaries of electoral districts away from the legislature and put it in the hands of an independent committee. Together the two measures represent a shot at a legacy for a governor who runs a state that has the lowest credit rating of any in the U.S. —*Christopher Palmeri and Michael B. Marois*

The bottom line *Schwarzenegger and his allies hope their Proposition 14 victory will help end California's political gridlock.*

Quoted

"I certainly don't think it would prevent the turmoil coming up, and I doubt very much it would have had much impact on the turmoil we have just experienced."
—Arthur Levitt Jr., former Securities & Exchange Commission chairman, on Congress' plan to overhaul financial regulations at a Bloomberg conference in Washington on June 15



G-20

The Tactful Ways of a Washington Sherpa

▶ **Michael Froman's role: Making sure leaders talk to each other**

▶ **"The President goes to Toronto in a position of strength"**

President Barack Obama's schedule for the G-8 and G-20 meetings later this month is crammed with back-to-back sessions with fellow heads of state on an array of topics ranging from stimulus spending to trade imbalances to currency fluctuations. He will rely on one trusted aide to keep track of it all, Harvard University Law chum Michael Froman, deputy national security adviser for international economic affairs.

As Obama's "sherpa"—a familiar Washington term borrowed from the Himalayan mountain guides—Froman will be at the President's side as he tactfully prods French President Nicolas Sarkozy or German Chancellor Angela Merkel to strengthen their financial systems and increase their banks' capital levels, or as he tells global leaders not to count on U.S. consumers to lead the world recovery.

One of the biggest challenges at the June 25-26 meeting of the Group of Eight in the Ontario resort of Muskoka and the June 26-27 Group of 20 confab in Toronto, Froman says, will be to keep the summiteers focused on the agenda. "People will try and deflect attention to other issues," he says. "One of the roles of the sherpa is to bridge the gap between what the bureaucracy serves up and what leaders want to talk about."

Much of the tension in Toronto will focus on the response to the sovereign-debt crisis roiling Europe and threatening to infect global markets. The U.S. has been pushing European nations not to move too fast in trimming the stimulus-spending programs intended to fight the 2008 financial crisis. While France and Germany have announced fiscal tightening to shrink deficits, the U.S. is concerned that such measures could depress global demand. Froman, 47, a former Citigroup executive and protégé of former Treasury Secretary Robert E. Rubin, says "there is broad consensus among the G-20 about the importance of fiscal consolidation." (Just 15 months ago, at the G-20 summit in London, the issue was just the opposite: how to persuade every country to spend more. Now the debate is about determining which countries can spend less.)

Ahead of any global summit, there's a sherpa circuit, with visits to the host country's natural and historic treasures. The idea is to build relationships by mixing work with play. Last February, for example, the G-8 sherpas went on a dog-sledding expedition in Yellowknife, Canada, where they discovered that 40 below is the same in Celsius as it is in Fahrenheit. Only the Russian delegate brought the proper hat.

Most of the heavy lifting in Toronto will have been done before the leaders arrive. "The leaders are not gathering for a drafting session," says Daniel M. Price, a lawyer at Sidley Austin and President George W. Bush's last sherpa. "The key benefit of these summits is the interactions among the leaders." Although the leaders appear to be alone, they really aren't. Sherpas listen in on their working dinners, huddled together just off the dining room, exchanging small talk and gathering intelligence.

This will be Froman's fourth summit as Obama's top sherpa. Since the first summit of Obama's Presidency, there's been another fundamental shift: The U.S. is no longer to blame for the world's economic ills. "The President goes to Toronto in a position of



Froman

FROM LEFT: JAY MALLIN/BLOOMBERG; RONALDO SCHEMIDT/AFP/GETTY IMAGES

strength," says Froman. U.S. banks "went through transparent stress tests, raised new capital, and took steps to clean up their balance sheets," he says. The message: The ball is now in Europe's court. —*Hans Nichols*

The bottom line *This time, Obama will not attend the G-20 summit as the head of a country causing economic turmoil.*

Private Equity

A Tax Hike Has Carlyle Up in Arms



JULIA EWAN/THE WASHINGTON POST/GETTY IMAGES

- **Fund chiefs were caught unawares by a tax clause within a jobs bill**
- **The new investment partnership tax "is discriminatory and inequitable"**

For David Rubenstein, the founder of private equity firm **Carlyle Group**, the prospect of losing a three-year fight over legislation that would force him to pay higher income taxes was bad enough. Then, in late May, he discovered a clause in the same bill that would more than double the taxes he would owe if he sold his stake in the firm or took it public.

Rubenstein became one of several high-profile private equity executives who personally took to the Capitol's corridors to pursuade lawmakers to remove the clause. Rubenstein visited Senator Max Baucus (D–Mont.), the Finance Committee chairman whose panel oversees all tax legislation. He also got an audience with Senate Majority Leader Harry Reid (D–Nev.). Other private equity chiefs, including Glenn Hutchins, co-founder of **Silver Lake Financial Management**, and David Bonderman, founding partner of buyout firm **TPG**, also called on lawmakers.

They argue that the clause, part of a broader jobs bill, is a tax on the value of investment partnerships that no other business owner is required to pay. It is buried in three-year-old legislation meant to raise taxes on so-called carried interest, or the share of profits that some private equity and hedge fund managers receive for successfully investing other people's money. That measure would more than double taxes on those partnership profits, from the currently low capital gains rate of 15 percent to higher ordinary income tax rates, now topping out at 35 percent.

In case financiers are tempted to sell their firms to avoid paying the new tax, lawmakers also imposed the higher levy on the proceeds of any stake sale or share offering. Private equity funds and other investment partnerships say they would be the only U.S. businesses unable to take advantage of lower capital gains levies in a sale. "That is discriminatory and inequitable," says Douglas Lowenstein, president of the Private Equity Council, a Washington trade group.

The provision would make an IPO expensive for Rubenstein and his partners. Carlyle spokesman Christopher Ullman acknowledges that the firm has considered going public for years, and that the economics of doing so would be fundamentally changed if the clause became law. Ullman says no public sale of shares is imminent.

The measure with the tax increases passed the House in May and is stalled in the Senate by lawmakers worried about adding to the deficit. Meanwhile, the lobbying by private equity executives may be having some effect. Senator Evan Bayh (D–Ind.) objects to the proposal's impact on sales of buyout firms and other partnerships. Baucus, so far, is not budging. He says he spent "hours and hours" with fund executives before deciding to adopt the clause, after getting advice from the Joint Committee on Taxation to keep it. Victor Fleischer, a University of Colorado law professor whose research was used by lawmakers to draft the tax provision, agrees that it's "absolutely necessary" to keep investment funds from avoiding the new tax. "Fund managers are going to be treated worse than a restaurant founder, but I'm O.K. with that," he says. —*Ryan J. Donmoyer*

The bottom line *A proposed tax hike would make it costly for partners in private equity firms such as Carlyle Group to sell their shares.*

What a Downer

Without new federal funds, spending cuts by state and local governments may act as a drag on the U.S. economy into 2011, only the second time in more than 50 years that such reductions have restricted growth for three consecutive years.
—*Rich Miller and Anthony Feld*

127

BILLION DOLLARS

Amount of states' total budget gap, as 46 of the 50 prepare for the July 1 start of the fiscal year

48

BILLION DOLLARS

Level of emergency federal aid President Obama is seeking to help state and local governments with Medicaid expenses and to avoid teacher, firefighter, and police layoffs

25

BASIS POINTS

Estimated loss of U.S. economic growth in both 2010 and 2011 if state and local governments cut spending to balance their budgets

DATA: NATIONAL GOVERNORS ASSN., NATIONAL ASSOCIATION OF STATE BUDGET OFFICERS, MOODY'S ANALYTICS

James Warren

Governing by the Numbers, And the Numbers Are Good

Indiana is one of 10 states that has seen its unemployment rate go down in the past year, from 10.5 percent in May 2009 to 9.8 percent in April 2010. It has a budget surplus and a triple-A bond rating. Property taxes and the state payroll have gone down. For the first time since the 1970s, more people are moving to the state than leaving.

Cruising past one of the state's abundant cornfields on June 9, Governor Mitch Daniels (R) has more reasons to feel good every day. An hour before, the former **Eli Lilly** executive announced that a computer-design firm rebuffed the advances of Virginia and will expand into what was a Noblesville food mill. Checking his BlackBerry, he reads that **Chrysler** will invest $300 million to upgrade two **Kokomo** transmission plants. Now he's headed to Marion, to announce that the town will soon be home to a Chinese furniture maker's first assembly and wholesale center in the U.S.

"Government's the last great monopoly, overcharging and underserving its customers. It's not a business but can be more businesslike," says Daniels during a diner stop for a Styrofoam cup of black coffee. Daniels has tried to turn his administration into a case study of how a private-sector mentality can transform public policy. Partly by tying cash and tax incentives to job creation, Indiana, a state with just 2 percent of the nation's population, has generated 7 percent of the nation's new jobs this year. He saved millions of dollars centralizing and contracting out state services, including printing to **Pitney Bowes**, computer purchases to **Dell**, and prison food to **Aramark**, cutting the cost from $1.43 a meal to 99¢ in the process. "And," says Daniels, "the food's better."

After serving as an adviser to Indiana Senator Richard G. Lugar (R) and briefly to President Reagan, Daniels spent a decade as a Lilly executive in Indianapolis. He had risen to head of corporate strategy when George W. Bush beckoned him back to Washington as the director of the Office of Management & Budget. "I learned almost nothing at OMB that relates to [being governor]," says Daniels. "What I learned, I learned in business."

He returned home and toppled a Democratic incumbent in his 2004 gubernatorial run, filled his cabinet with smart private-sector types such as Earl A. Goode (the former president of **GTE Information Services** and his current chief of staff), and went to work. An executive order giving state workers collective bargaining rights? Ditched. Daniels sold the state toll road to a Spanish-Australian consortium for a head-turning $3.9 billion before the recession (there's self-financed road construction everywhere, itself a lure to business) and put most of the state on the Eastern time zone, ending a history of multiple time zones that drove businesses crazy.

Daniels has the self-confidence of a politician riding high and the data-driven focus of a policy geek. Metrics thrill him, and not surprisingly most of his government tweaks started with an offending number. He saw the number of child fatalities and more than doubled the number of caseworkers, from 696 to 1,590, reducing each worker's load and cutting the deaths by 40 percent. He assessed rising traffic fatalities and increased the number of troopers, cutting deaths to 680 in 2009 from 814 in 2008. The state was spending $37,662 in incentives to create each new job, so he ditched "the worthless" Commerce Dept. The outlay is now $8,701 per new job.

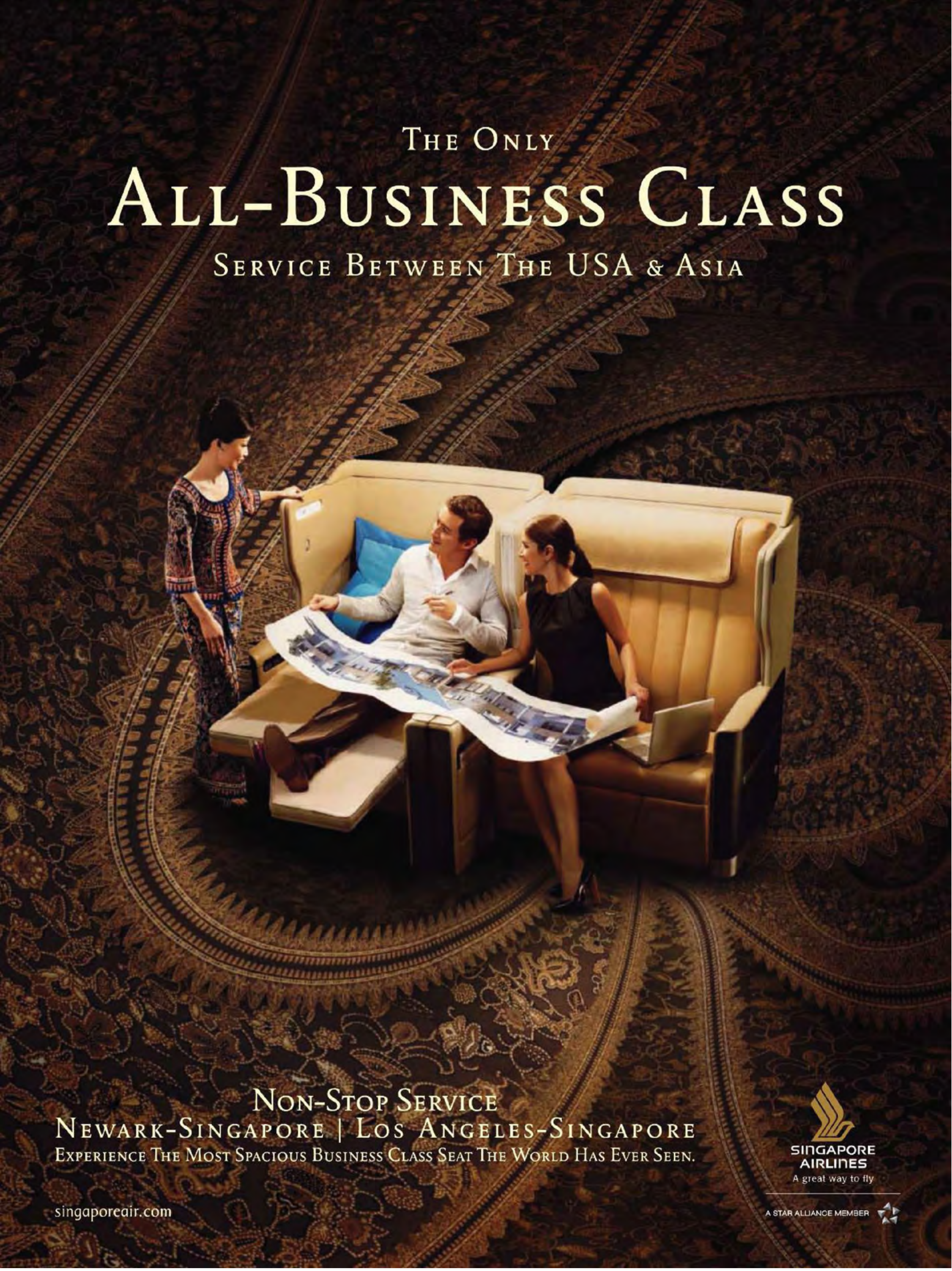


Daniels is riding high in the polls, with approval ratings above 60 percent

A staunch conservative—he derides President Barack Obama's stimulus package and auto bailouts as "nationalization"—Daniels admits his approach isn't always best. He didn't adequately prepare citizens for the toll road sale to a foreign entity and botched an attempt to privatize the welfare system by trying to force beneficiaries—who are often impoverished and technologically ignorant—to enroll online for Medicaid and food stamps. He doesn't see government as the central investor in Indiana's future but knows there are certain areas in which it can't be replaced; he explains the decision to double child welfare caseworkers, for instance, because, "[you] can't find those in the Yellow Pages."

His aggressive use of private-sector tactics in the public sphere has rankled legislators in both parties, who at times feel they're being treated as underlings to the smartest guy in the room. That hasn't stopped pundits and fellow Republicans from putting Daniels' name forward for the GOP nomination for President in 2012. He doesn't have Sarah Palin's rhetorical fire, and at a shade under 5'7" he won't look terribly imposing next to Tim Pawlenty or Mitt Romney. Daniels, meanwhile, has perfected a myriad of banal ways to deflect the speculation. But if numbers matter as much as he says they do, consider these: He won reelection by a hefty margin of 18 points in 2008 even as Obama carried the state. And Daniels' current approval ratings are hovering between 60 and 70 percent, while the President's is at 52 percent. Those just might be actionable figures. Ⓑ

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JUSTIN SULLIVAN/GETTY IMAGES

Mulling Options, Dell Considers Going Private

▶ **A big acquisition may be another cure for the computer maker's lagging sales and stock price**

▶ **"They need to do something dramatic, something crazy"**

In the three-and-a-half years since he resumed running **Dell**, the computer maker he founded 26 years ago, Michael S. Dell has made more than 10 acquisitions, cut some 10,000 jobs, and hired executives from **Motorola** and **Nike** to put a little flash in the company's products. Dell bought Perot Systems for $3.6 billion last year to expand into computing services.

None of that has worked very well. The company's stock has fallen 42 percent since Jan. 30, 2007, the day before Dell returned from semi-retirement. Over that period, **Hewlett-Packard**'s stock has gained 11 percent, and **IBM**'s is up 31 percent.

Slumps happen. There's less precedent for Dell's statement before an audience of investors and analysts on June 3 in New York. An analyst asked him if he'd ever thought about taking the company private: "Yes," he answered. There was silence in the room, and Dell declined to answer any more questions on the matter.

"When companies talk about going dark, typically you think about small companies with problems," says Jarrad S. Zalkin, a vice-president at investment bank TM Capital. "You don't think about a company like Dell." Company spokesman Jess Blackburn declined to talk about Dell's statement. Michael Dell also declined to comment.

Going private "really doesn't change anything because the fundamental disadvantages don't go away. The competitors are still there"

Dell, 45, founded the company out of his University of Texas dorm room and built it into a model of manufacturing efficiency. Executives from other companies would visit its Round Rock (Tex.) headquarters to see how he did it. A lot has changed since then. The industry's focus has shifted toward mobile computing, software, and technology services. IBM and HP have made big commitments to software and consulting, a much

higher-margin business than building and selling personal computers. Dell still gets 24 percent of its revenue from desktop PCs. Even after the Perot Systems acquisition, services account for only 13 percent of its sales. **Cisco Systems** is angling for a piece of Dell's $6 billion server business. While Dell introduced a tablet computer called Streak in May, it didn't steal much thunder from **Apple**. "This transformation is incomplete," Dell said at the June 3 investor conference.

Some analysts say Dell needs a deal on the scale of HP's $13.2 billion acquisition of Electronic Data Systems in 2008. Shaw Wu, an analyst with Kaufman Bros, says one promising match might be Silicon Valley's **Juniper Networks**, which makes routers used by phone carriers and cable companies. The market for such networking equipment is $7.1 billion. "They need to do something dramatic, something crazy," Wu says. The problem with pursuing acquisitions is that money is becoming tight for Dell. Sales fell 13.4 percent, to $52.9 billion, in Dell's 2010 fiscal year ended Jan. 29. On June 10, Dell set aside $100 million of its first-quarter profit for a potential settlement with the Securities & Exchange Commission over the computer maker's relationship with **Intel**. (Both companies declined to give more information on what the SEC is investigating.)

Going private and escaping investor scrutiny might give Dell the time and flexibility to develop its service business so it could better compete with IBM and HP, says Zalkin of TM Capital. "You can move much more boldly as a private company," he says.

Still, taking the computer manufacturer private would be expensive. Dell had a $27 billion market value at press time, and technology companies typically fetch a 25 percent premium when they're sold, says Zalkin. Other analysts and bankers question whether going private would solve any of Dell's bigger problems. It "really doesn't change anything, because the fundamental disadvantages don't go away," says Kaufman's Wu. "The competitors are still there."

—Connie Guglielmo and Aaron Ricadela

The bottom line *Founder Michael Dell says he has considered taking his company private, a dramatic attempt to reverse fortunes at the company.*



Dance Central, unveiled at E3, the annual game confab in Los Angeles, scores players on how accurately they follow the routines displayed on-screen. Made by Rock Band creator Harmonix, the game works with Microsoft's Kinect, the new Xbox 360 console add-on that uses sensors to detect player movement.

MICHAL CZERWONKA/GETTY IMAGES

Entertainment

TV Makers Move Into Online Content

- ▶ Sony will sell a Google TV and is expanding its online movie service
- ▶ "If it's going to happen, we might as well be one of the first to embrace it"

Over the next few months, **Sony** and its competitors will introduce a new generation of Web-connected televisions—and services that will stream movies, TV shows, and music over the Internet and onto those sets. The idea is to make it easier for consumers to bypass cable and effectively create their own personal TV channels.

That may sound a lot like what many people already are doing by tapping into **YouTube**, **Hulu**, and other entertainment Web sites. What's different is that Sony and the other manufacturers are hoping to go after advertising dollars as well as subscription revenue and pay-per-view fees. Instead of using computers and mobile devices for their daily dose of free television, viewers would pay Sony or another company to watch on much more expensive equipment.

At least that's the plan.

Sony could use a new product. The company has lost $1.4 billion over the past two years, including restructuring charges. Research firm iSuppli says Sony has fallen to third place among TV manufacturers, behind **Samsung** and **Vizio**. According to Sony filings, its TV business is losing money. Chief Executive Howard Stringer says that as consumers watch less TV in their living rooms, the industry needs to adjust quickly to the changing



A peek at private equity returns page 47 ►

ways viewers take in entertainment. Last month, Sony unveiled the prototype of a TV that will deliver video and music over the Web in partnership with **Google**. These Google TVs are expected to be in stores by Christmas. "You can't get out of the way of this level of competition and choice," says Stringer.

Earlier this year, Sony introduced a video-streaming service called Qriocity (pronounced "curiosity") that linked to its high-definition Bravia TV sets and Blu-ray players, which both connect to the Web. While **Netflix** offers video streaming free of charge to subscribers of its mail-delivered DVD service, Qriocity will charge $2.95 or more each time a user clicks to watch a movie. Qriocity is available to the 35 million people who own Sony PlayStation 3 game consoles, which also connect to the Internet. The Tokyo-based company, which owns **Columbia Pictures** and **Tri-Star**, has been negotiating with other studios to let viewers stream movies for as much as $30 shortly after they open in theaters.

Web delivery of TV content won't be a huge revenue stream for years. Excluding income from video games, online video revenues may rise to $800 million by 2014, up from $180 million this year, according to researcher Parks Associates. This year cable and broadcast companies will take in $51 billion from advertising alone, forecaster Magna Global says.

Grabbing a share of that advertising revenue is the ultimate goal of TV manufacturers. Samsung says it plans to launch an on-screen virtual storefront of applications for shopping, games, and other activities that would allow advertisers to reach customers on its TVs, Blu-ray players, PCs, and cell phones. "This is a good time to start introducing another way of accessing content and putting control into the consumer's hands," says Eric Anderson, vice-president for content and product solutions at Samsung Electronics America.

Cable companies and theater owners are responding to the new threat. **Comcast** and **Time Warner Cable** are providing subscribers with on-demand access to content on all manner of devices. Theater chains have threatened to pull movies out of circulation if Sony and other Hollywood studios begin offering them at the same time on their television sets.

Stringer, acknowledging the turf battles to come, says everyone's concerns will be worked out over time. "If it's going to happen," he says, "we might as well be one of the first to embrace it."
—Cliff Edwards and Ronald Grover

The bottom line *Sony and other TV manufacturers are about to introduce Net-compatible sets as well as services to feed them content.*

Venture Capital

GM Plots a New Road To New Technology

- ► The company's $100 million fund will scout for green startups
- ► "You can't be at the forefront doing everything yourself"

Research and development budgets at General Motors took a hit during the company's bankruptcy. Now, as GM begins to rebuild, it's looking to outside entrepreneurs for help in developing new technologies. The Detroit automaker has invested $100 million in its new General Motors Ventures fund, aimed primarily at finding and backing clean, green startups.

Vice-Chairman Stephen J. Girsky, who joined GM's board of directors last July, says some company engineers and researchers floated the idea of a venture capital fund a few years ago, but management didn't show much enthusiasm. Girsky, 48, a former automotive analyst with Morgan Stanley who later oversaw industrial investments for private equity firm Centerbridge Partners, says that when the suggestion was revived, GM Chairman and Chief Executive Officer Edward E. Whi-

Lunar Rovers, Trains, and Automobiles: GM Technology



1912

Cadillac introduces a vehicle with the first electric self-starter, freeing drivers from having to crank their cars to get them running.



1934

General Motors' two-cycle engine runs the first diesel-powered train. It's the beginning of the end for coal-fired locomotives.



1952

With a Detroit-area doctor, GM engineers co-develop the first mechanical heart, used to keep patients' blood pumping during surgery.



1962

The Oldsmobile F85 Cutlass Jetfire and Chevrolet Corvair Monza Spyder are powered by the first mass-produced turbocharged engines.



1971

The Lunar Roving Vehicle, used during the Apollo 15 mission, features GM-built wheels and chassis.



1996

Leasing begins for the EV1, the first fully modern electric car since the 1930s. The program was discontinued in 1999.

TRAIN: HEDRICH BLESSING COLLECTION/CHICAGO HISTORY MUSEUM/GETTY IMAGES; LUNAR ROVER: CORBIS; EV1: AP PHOTO

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Technology

tacre Jr. didn't need to be convinced: "I brought it to Ed, and within about five minutes he said, 'Go with it.' "

Some large corporations, including **Google**, **Intel**, and **AT&T**, use venture capital to tap into outside innovation, although company-owned venture capital funds have been on the wane for a decade. In 2000, U.S. corporate venture-capital funds did $16.2 billion in deals, about 16 percent of American VC investments. Last year that figure was just $1.3 billion, or 7 percent of the total, according to the National Venture Capital Assn. GM's fund is unique in the automobile industry and instantly turns the company, now 61 percent owned by U.S. taxpayers, into a midsize venture-capital player.

Jon J. Lauckner, president of the fund, says he's interested in technologies that can boost the capacity of batteries and get them to charge faster. Lauckner, a 31-year GM veteran, was on the development team of the Chevrolet Volt, a gasoline-electric hybrid car set to go on sale in November. The Volt's battery can take it about 40 miles before a gas-powered engine kicks in to recharge it. Short battery life is the primary reason so few electric cars are on the road.

Lauckner, 52, sees potential in silicon nanowires, clusters of silicon "hairs" placed in the anode of a battery, where lithium atoms are stored. Since silicon can store more energy than carbon, used in today's lithium ion batteries, the technology could increase the energy stored by several times, he says. He's also keeping an eye out for companies with expertise in lightweight materials and other methods for raising fuel economy and lowering emissions in conventional gasoline engines. David E. Cole, chairman of the Center for Automotive Research in Ann Arbor, Mich., sees General Motors Ventures as a cost-effective way to bring in original ideas. "You can't be at the forefront doing everything yourself," he says.

GM has the luxury of being less concerned than pure VC firms with return on investment. "We won't be looking for the next Google," says Lauckner. "We'll be looking for technologies for our core business." —*David Welch*

***The bottom line** A venture-capital fund could be a cost-effective way for General Motors to acquire new green technologies.*

Quoted

"The iPad simply is not a safe platform for those that require a secure environment."
—Escher Auernheimer of Goatse Security, in a June 14 blog post. His group uncovered e-mail addresses of 114,000 iPad owners because of a flaw in AT&T's website



Global Competition

China's Big Supercomputer Play

- State-backed Dawning built the world's second-fastest computer
- "When they find the right technology, they go full in"

Dawning Information Industry in Beijing drew a lot of attention on May 31 when its Nebulae supercomputer clocked in at 1.271 petaflops, making it the second-fastest computer in the world. (A petaflop is a quadrillion calculations per second.) While the Chinese government-backed company's next computing stunt is likely to be less heralded, it may be more significant. It plans to use a Chinese-made processor in a supercomputer expected to go on line next year.

The Loongson, as the chip is called, would replace at least some of the chips made by U.S. makers **Nvidia** and **Intel** that were used in the Nebulae. For China, it would be a small victory on the way to reaching its goal of

The Top-Five Supercomputers
Speed in quadrillions of calculations per second

	Maker	Model	Speed	Country
1	Cray	Jaguar	1.759	U.S.
2	Dawning	Nebulae	1.271	China
3	IBM	Roadrunner	1.042	U.S.
4	Cray	Kraken XT5	0.832	U.S.
5	IBM	Jugene	0.826	Germany

DATA: Top500 Project

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A boost in salary can be the ultimate motivator. Or not.

"A little bit of money really helps motivation, but around a certain point… it starts to backfire."

Dan Ariely
Professor
Duke University



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Technology

291

BILLION DOLLARS

Projected global semiconductor industry revenue for 2010. Last year's total was $226 billion.

DATA: SEMICONDUCTOR INDUSTRY ASSN.

using more Chinese-made parts in supercomputers and ultimately selling them to other companies.

If a significant player like Dawning can trust Chinese chips like Loongson, makers of less complicated computers "can have a new option," says Sha Chaoqun, manager of the product division at Dawning. The Loongson chip was developed by a government institute.

As Dawning's Loongson project demonstrates, Beijing's supercomputer push isn't only about building hyperfast machines used for quantum chemistry, climate modeling, and other tasks that require a lot of power. China aims to use its supercomputers to nurture less sophisticated and more commercially lucrative products. "The government wants to encourage the development of local technology through the buildup of these supercomputer centers," says Uko Tian, an analyst in Beijing with market research group Gartner. China, which used to concentrate its supercomputing in Shanghai, has opened 10 such facilities nationwide over the past year.

"When they find the right technology, they go full in," says Andy Keane, Nvidia's general manager in charge of the company's supercomputing business. "This isn't just building computers. It's building one of the largest computers in the world very, very quickly."

Why the rush? Beyond their use by scientists and weather forecasters, the computers are used by the People's Liberation Army for weapons research and are too sensitive to entrust to foreign vendors, says Michael Clendenin, managing director of RedTech Advisors in Shanghai.

Dawning hopes its supercomputing success will cross over into the server market: Until now it has lagged behind the international competition. Although China is the world's third-largest server market, behind the U.S. and Japan, Dawning's share of the market was just 5.7 percent last year, well below **Hewlett-Packard**'s 25 percent, **Dell**'s 24 percent, and **IBM**'s 21 percent, according to International Data. Dawning "doesn't have the scale, it doesn't have the business relationships," says Clendenin. "There's a lot of competition that is very low-cost."
—*Bruce Einhorn*

The bottom line *Dawning's Nebulae supercomputer was built with chips from Intel and Nvidia. Its next supercomputer will showcase Chinese chips.*

Social Media

Another Day, Another Virtual Dollar



ILLUSTRATION BY GREG MABLY

▸ **CrowdFlower pays its army of online workers in digital cash**

▸ **"Pretty much like any other form of putting forth an effort for a reward"**

Amanda Dorsey has spent dozens of hours categorizing search results on eBay.com, verifying search-engine links, and doing other online jobs. Dorsey doesn't get paid in legal tender. She takes her wages from San Francisco employment agency CrowdFlower in the form of virtual money, with which she buys virtual goods: a gray winter coat and a sexy yellow doc-



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tor's uniform for her avatar—her virtual self—on TinierMe.com, a chat and game site. There's nothing odd about it, says Dorsey, a 28-year-old unemployed writer and editor in Florida. "Doing work for virtual currency is pretty much like any other form of putting forth an effort for a reward," she says.

Dorsey is one of about 100,000 people in CrowdFlower's on-demand workforce who have taken pay in virtual rather than real dollars, says Chief Executive Officer Lukas Biewald, who also pays with the real stuff. Virtual cash can be used to buy seeds or weapons to play FarmVille, Mafia Wars, or other popular games on social media sites like Facebook. Players accumulate virtual money by earning points within a game or by converting real dollars into pretend currency. Consumers will spend $1.6 billion on virtual goods in the U.S. this year, double 2009's tally, according to investment bank ThinkEquity.

CrowdFlower's twist is offering gamers a way to do real work for their fake living. It pays to place help-wanted ads within such games as FarmVille, created by Zynga. People who answer the ads with companies that have online tasks to dole out are then placed by CrowdFlower, which gets compensated by those companies in real, green money. Biewald says he expects to pay virtual wages worth about $1 million this year, compared with less than $50,000 last year. "We're just scratching the surface," he says.

CrowdFlower pays on a per-task basis, at a rate set by the companies that hire it to find workers. One client is PeopleBrowsr, a consulting firm that monitors comments about brands on social networks such as Twitter. The firm uses CrowdFlower to find workers to sift through as many as 40,000 tweets an hour and categorize each as positive, negative, or neutral. Workers typically get about 1¢ a tweet, or the equivalent in digital currency, says PeopleBrowsr CEO Jodee Rich.

Biewald says demand for virtual rather than real wages skews young: "There will be a whole new generation of kids growing up who won't really see the difference." *—Joseph Galante*

The bottom line *Employment outfit CrowdFlower is paid real money to staff online jobs, and often pays people in virtual scrip.*

Innovator

Gary Martz



The Intel engineer saw the possibility—and the payoff—of WiDi, a technology that beams Web video from laptops to TVs

Imagine sitting on your couch with a notebook PC on your lap, chuckling at a *Saturday Night Live* clip on NBC.com. You hit a button and a crisp, high-definition version of the sketch plays on the TV across the room. Gary Martz, a senior product manager in Intel's wireless products unit, championed that idea, though Intel's top brass tried to deep-six the concept. Then major PC makers and retailers lined up behind it. Today Intel executives say they've come up with the next must-have feature in personal computing.

Wireless Display, or WiDi, uses the Wi-Fi technology that wirelessly connects computers to the Net. Martz's team repurposed radio chips and antennas to send and receive data simultaneously and transmit whatever a computer is displaying to a receiver plugged into the back of a TV. Dell, Toshiba, and Sony offer the feature on some of their laptops, which come with a free TV adapter made by Netgear.

Intel nearly killed off WiDi because engineers didn't believe that a Wi-Fi radio, already busy transmitting and receiving data, could also deliver quality video. They worried it would require extra chips, which would make the computers more expensive and less attractive to consumers. Wi-Fi is also susceptible to interference from household devices such as microwaves, and its quality drops when signals have to travel through walls. "They literally laughed me out of the room," says Martz, 38, an industrial engineer with an MBA from the University of Michigan. Martz thought such obstacles could be overcome and consumers would embrace WiDi if it were easy to use.

Martz says Intel, whose chips run more than 80 percent of computers, is far more comfortable talking to IT managers about geeky stuff than making technology consumer-friendly. So he decided to take his technology on the road to build support among potential customers. Martz's associates took early (and barely tested) versions of their invention to PC makers in Taiwan and Tokyo and then to Minneapolis-based retailer Best Buy. After demonstrations that they were never entirely sure would work, the group won enough positive feedback to persuade top Intel executives to fund the project.

Intel formally unveiled its WiDi feature in January, and Martz thinks it will eventually show up on tablet PCs and handhelds, though he wouldn't discuss timing or which companies plan to use the technology. WiDi's success may depend on how quickly Intel can get TV makers to build the technology into their sets, said Jim McGregor, an analyst at market researcher In-Stat. "It's got to be an invisible cost to the consumer." (None of the five TV makers contacted by *Bloomberg Businessweek* would comment.)

Martz saw the potential for widespread acceptance when he persuaded his non-techie father-in-law to buy a WiDi laptop: "I told him, 'if you have problems, call me.' He didn't." *—Ian King*

Background ▸ Engineering degree from U. of Washington, MBA from Michigan

Quote ▸ "They literally laughed me out of the room"

Challenge ▸ Getting TV makers to build WiDi technology into sets

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Among Top Private Equity Firms, Fortress Falls Short

▶ **Newly disclosed figures give unprecedented detail on its investment performance**

▶ **"It might make sense to wait to see if things turn around"**

Private equity firms tend to keep their returns to themselves, sharing some figures with potential investors. Now the firms that are publicly traded or considering going public are disclosing more of their results in regulatory filings, giving a detailed view of their performance for the first time. The comparisons are not flattering for **Fortress Investment Group**.

Wesley R. Edens has made $20.9 billion in private equity investments for pensions, endowments, and wealthy individuals since co-founding Fortress 12 years ago. The market value of his funds' holdings, including distributions already paid to clients, was $19.6 billion as of Mar. 31, according to a May 10 regulatory filing. The total decline in value: $1.3 billion.

Older firms that enjoyed the boom of the '90s have fared far better. **Kohlberg Kravis Roberts**, in business since 1976, has produced a $42.8 billion profit for investors. Since first putting money to work in 1987, **Blackstone**, the world's largest private-equity firm, has turned $32.3 billion in invested capital into $49.4 billion. **Apollo Management** has invested $29.3 billion since starting its first fund in 1990. That amount is now valued at $46.8 billion, including distributions.

The numbers for all four firms include distributions and the value of assets that have not yet been sold—which could change over time. Because the investments were made over different periods, it isn't possible to calculate a simple long-term return for each. Officials at the four New York-based firms declined to comment. Fortress and Blackstone are publicly traded; KKR and Apollo plan to list shares on the New York Stock Exchange. Carlyle Group and other large private equity firms that are privately held do not disclose detailed performance figures.

Long-Term Scorecard

Here's how much four big firms have generated for investors, including unrealized gains and losses

Firm	Amount	Period
Apollo	$17.5	billion since **1990**
Blackstone	$17.1	billion since **1987**
Fortress	–$1.3	billion since **1998**
KKR	$42.8	billion since **1976**

The filings make it easier for prospective clients to compare performance. Blackstone, run by co-founder Stephen A. Schwarzman, aims to close its seventh buyout fund this month. Fortress' Edens plans to raise a new fund next year, after abandoning an attempt in late 2009. "Managers have traditionally obfuscated performance," says Harold Bradley, chief investment officer of the Ewing Marion Kauffman Foundation, which oversees $1.7 billion. "That prohibited comparative analysis. The new data is a start."

Fortress' filing specified how much capital each of its funds invested, how much it returned to clients, and what the remaining holdings are worth. Fortress included information on how much its investments need to gain for the firm to earn incentive income. Those figures show 12 of its buyout funds are currently below that mark and collectively would need to rise in value by $9 billion to claim a share of profits. The funds haven't lost any companies they own to bankruptcy, and the holdings may recover. Fortress, like other firms, also collects management fees from its funds; investors in its funds do not share in that income.

The filings shed light on how difficult the going has been for private equity recently. Fortress' performance suffered in part because Edens has raised and deployed more than half his private equity funds since 2005, when prices for buyouts surged and then the financial markets collapsed. So far, Fortress has a paper loss of $5 billion on those investments. Blackstone had an unrealized loss of $861 million in the period since 2005, and KKR buyout funds are down $708 million. Funds at Leon Black's Apollo posted a $2.2 billion profit.

Among the losing investments Fortress has made since 2005 is ski resort operator Intrawest, which this year restructured its debt. Investors in Fortress funds had seen their $1.7 billion equity stake reduced to 4¢ on the dollar as of Oct. 31. The 2007 Fund V has lost $1.7 billion of $3.6 billion in initial assets, as investments in railway company Florida East Coast Industries and a portfolio of loans Fortress calls MBS Holdings soured.

Blackstone has also had to restructure some big stakes. Its Hilton Worldwide hotel chain in April completed a deal to reduce debt by almost $4 billion and extend the maturity of its loans by two years. Black-



Wes Edens co-founded Fortress in 1998

MATTHEW STAVER/BLOOMBERG

stone bought Hilton in 2007 near the top of the market for about $26 billion, including assumed debt.

Fortress got off to a good start. Two early private equity funds, raised in 1999 and 2002, have internal rates of return of 26 percent and 37 percent, respectively, since inception. Its Fund III, raised in 2004, returned an annualized 1.1 percent from inception through Mar. 31. The rate for the 2006 Fund IV is a negative 9.7 percent.

Potential investors in Fortress funds are more likely to focus on the later numbers. "If we were to consider investing in Fortress, the first issue would probably be the performance of the more recent, larger vintages," says William Atwood, who helps oversee about $10 billion as executive director of the Illinois State Board of Investment. "It might make sense to wait and see if things turn around."

As for investors who bought stock in Blackstone and Fortress, their results have been disappointing. As of June 16, Blackstone shares have lost 66 percent since the company went public in June 2007. Fortress shares have lost 80 percent since their debut in February 2007.
—*Cristina Alesci*

The bottom line *No matter how smart you are, timing matters. Private equity firms, like other investors, found it far easier to make money in the boom.*

Real Estate

The New Fad in Fraud: House Flopping

- **Get the bank to agree to a low price and profit from a quick resale**
- **"Criminals are always trying to find ways of profiting"**

Two Connecticut real estate agents found a way to make money on houses during the bust: buy low, sell fast. Their strategy was profitable. It was also illegal. Sergio Natera and Anna McElaney are scheduled to be sentenced in federal court in Hartford in August after pleading guilty to fraud in February. Their scheme involved persuading lenders to approve short sales—selling homes for less than the balance owed on the mortgage. They did so without disclosing that there were better offers than the ones the banks accepted, which they were legally required to do as licensed real estate agents. The two then flipped the houses for a quick gain.

The FBI, the California Real Estate Dept., and mortgage-finance company **Freddie Mac** have warned that such schemes may be spreading, thanks to a housing bust that has left homeowners owing more than their properties are worth. The scams threaten to deepen losses for lenders that increasingly are agreeing to short sales as an alternative to costlier foreclosures.

"Short sales are an important tool that can help both the bank and the borrower," says Morgan McCarty, executive vice-president for mortgage servicing at Birmingham (Ala.)-based **Regions Bank**, which lost money in the Connecticut case. "It's just that criminals are always trying to find ways of profiting."

An Obama Administration effort to boost short sales may be unintentionally increasing incentives for fraud, Neil Barofsky, special inspector general for the Troubled Asset Relief Program, wrote in an Apr. 20 report to Congress. Through the Home Affordable Foreclosure Alternatives Program, the government offers as much as $1,500 to servicers, $2,000 to investors, and $3,000 to homeowners who close short sales. "It appears that the program may lack necessary antifraud protections," Barofsky wrote.

A common scam involves a practice called "flopping," Barofsky said. Real estate brokers, investors, or home buyers convince a lender to sell a home for less than its loan balance without disclosing the fact that they have lined up someone willing to pay a higher price. They quickly resell the house for a profit, as in the Connecticut case, while the lender takes a loss.

"Flopping" occurs in more than 1 percent of short sales and may cost lenders $50 million this year, according to estimates from CoreLogic, a real estate research company. About 12 percent of existing home sales, or almost 622,000 houses, were short sales in the 12 months through April, data from the National Association of Realtors show. Regions Bank requires a full appraisal before a resale. It also demands short-sale buyers sign statements affirming the transactions are arm's length, with no hidden buyer-seller relationships, and that there are no agreements to resell the property.

In the Connecticut case, Regions Bank in April 2008 agreed to a short sale of a Bridgeport house for $102,375, unaware that Natera and McElaney had a bidder willing to pay $132,500, according to the plea agreements. Eight weeks after the bank sold for a loss, the pair resold the house for a $30,125 gain.

Natera's phone has been discon-

Drawing Board



nected, and he couldn't be reached for comment. Arnold Kriss, his defense attorney in New York, declined to discuss the case before sentencing. McElaney declined to comment when reached by phone. Her New York-based attorney, Mark Bederow, says he can't discuss specifics of the case. "The mere act of a buyer in a short sale selling again quickly isn't per se fraudulent," he says. "That's business." —*John Gittelsohn*

***The bottom line** During the boom, the game was to get houses appraised at more than they were worth. Now a low appraisal can aid a fraudulent sale.*

Stocks

Investigators Look at Diebold's Sudden Drop

- A scrap of news may have triggered frantic automated trading
- Computers analyze "the flavor of the words chosen"

Minutes before a June 2 meeting with investors, **Diebold** Chief Executive Officer Thomas W. Swidarski saw his company's share price plummet more than 30 percent in six seconds. As Swidarski tried to figure out what to say at the meeting, the price shot back up. By the end of the day, trading of the maker of cash machines had surged to about 11 times its usual volume. The stock closed at $29.08, or 3 percent above its opening price.

Trading specialists and enforcement attorneys at the Securities & Exchange Commission and the Financial Industry Regulatory Authority are examining what triggered the Diebold trades and whether the sell-off could have resulted from manipulation or inside information, according to people familiar with the matter who declined to be identified because the probe isn't public. Two stock exchanges, NYSE Arca and Nasdaq OMX Group, which reviewed the trades for misconduct and errors, determined they should stand.

The plunge may have occurred when a shred of Diebold news bounced into the growing network of computer programs that search out financial information, analyze it, and trade instantly without human intervention,

OPPOSITE: ILLUSTRATION BY SCHWADRON. THIS PAGE: JASON GROW/BIGSHOTSTOCK

The Financial Life

Seth Klarman



Making careful bets on a wide range of assets, he has a sterling record and manages more money than some better-known competitors.

Some hedge fund managers are famous for big scores—John Paulson made $15 billion shorting the housing market. Then there's Seth Klarman, who got rich by making money steadily over time. As markets began to collapse in 2008, the founder of Baupost Group focused on corporate bonds he calculated would yield solid returns even if the economy got worse. "We didn't have the degree of conviction Paulson had," says Klarman, 53, in an interview in his Boston office. "We don't deal in absolutes. We deal in probabilities."

Baupost has returned 19 percent a year, net of fees, since Klarman started it in 1983, vs. 11 percent for the Standard & Poor's 500-stock index. His record helped Klarman almost double Baupost's assets, to $22 billion, over the past two years—a period when the hedge fund industry was seeing withdrawals. He runs more money than better-known managers such as Ken Griffin and Steven Cohen.

A value investor who looks for securities he considers underpriced, Klarman says he's best at "complicated" situations where fewer investors compete for assets. "He specializes in illiquid, complex assets," says Thomas Russo, a partner in investment firm Gardner Russo & Gardner who has known Klarman since 1984. Baupost has invested in Parisian office buildings, Russian oil companies, and real estate the U.S. government sold after the savings and loan crisis of the early 1990s, says Russo.

More recently, Klarman scored big buying the bonds of Washington Mutual and Ford Motor at deep discounts. When he can't find investments he likes, he's not afraid to sit on his hands, keeping as much as 40% of the fund in cash. Lately it has been 30%. If the firm can't come up with enough opportunities, it may return cash to investors, he says.

These days, less than 10% of Klarman's portfolio is in U.S. stocks. Except for a brief time in March 2009, he says, "stocks haven't been at bargain prices for most of the last two decades." Recently, he's been looking at privately held commercial real estate. While the fundamentals for much of that property are "terrible," he says, it may pay off for those willing to wait long enough.

After graduating from Cornell, Klarman worked for renowned value investor Michael Price; he later earned an MBA at Harvard. His views are so closely watched by investors that his out-of-print book, *The Margin of Safety*, published in 1991, is offered on Amazon.com for more than $1,700. Bruce Berkowitz, named Morningstar's domestic stock manager of the decade, says Klarman stands out among fund managers because he's able to make money while holding cash and avoiding leverage. Says Berkowitz: "If he isn't Elvis, he's pretty close." —*Charles Stein*

Fund ▸ **Baupost Group, with $22 billion under management**
Strategy ▸ **Seeks undervalued, misunderstood assets**
Recent investment interest ▸ **Privately held commercial real estate**



The 50 top-performing companies page 55 ▶

Bailouts

Rising Tab for the Mortgage Mess

The bailout of Fannie Mae and Freddie Mac, already the largest on record, could reach $1 trillion. Fannie and Freddie, 80 percent-owned by taxpayers, hold or guarantee 53 percent of the nation's $10.7 trillion in residential mortgages. Their federal regulator is having them delist their shares, which have been trading for about $1 each, from U.S. stock exchanges. As of Mar. 31, borrowers were late on $338.4 billion worth of loans, up from $206.1 billion a year earlier. The companies have drawn $145 billion from an unlimited government line of credit. Here are four estimates of the final bill.
—Lorraine Woellert and John Gittelsohn

$160bn

The White House Office of Management & Budget made this estimate in February, saying that a strengthening U.S. economy could bolster the housing market and that the companies could earn enough to begin paying dividends to the government in 2012.

$230bn

In a December report, Barclays Capital analysts said this was the most likely tally, based on defaults doubling and losses averaging 50% on each loan. In the worst case, the bank sees defaults tripling, 60% losses, and a total cost of $500 billion.

$389bn

The amount Fannie and Freddie would need through 2019, according to a Congressional Budget Office estimate in August of last year. A big contributor to the total: $500 billion of subprime loans made before 2008 that are expected to have losses of 30% to 50% of principal.

$1tr

"A reasonable worst-case scenario," says Sean Egan, president of Egan-Jones Ratings, assuming a 20 percent loss on the companies' more than $5 trillion in loans and guarantees, similar to what other big mortgage companies, like Countrywide Financial, suffered.

market analysts said. Diebold's experience poses the same concerns about high-speed trading as the May 6 sell-off that erased $862 billion from the stock market in less than 20 minutes.

Diebold's June 2 freefall started after the SEC announced that the company would pay $25 million to settle allegations of fraudulent accounting. The accord was old news; a year earlier, Diebold had announced it agreed in principle to pay that amount to end the investigation of its discontinued practice of recording some sales before machines were delivered. The SEC on June 2 also filed suit against three former Diebold executives. At 12:22 p.m., the stock plunged $8 in six seconds, to $18.26, according to Bloomberg data. It recovered and was trading above $25 by 12:23 p.m.



Swidarski saw his company's stock drop more than 30% in six seconds.

The use of software to analyze press releases, headlines, and news stories and trade within milliseconds has taken off in the past three years, says Timothy Sargent, CEO of Quantitative Services Group. The software is based on algorithms that process historical data, events, or keywords that have moved stock prices in the past. "There is a parsing activity to look at the flavor of the words chosen," says Sargent. "Obviously, there will be negative words and positive words." (News for algorithmic trading is supplied by News Corp.'s Dow Jones, Thomson Reuters, and Bloomberg LP, the parent of Bloomberg News.)

Traders don't care if algorithms occasionally misinterpret data as long as the computers make the correct moves most of the time, says Sargent: "The dollars and the money to be made being right a majority of the time is enough to pursue these strategies."

To respond to the May 6 crash, the SEC and exchanges are instituting curbs on a trial basis. If a stock rises or falls 10 percent in less than five minutes, trading in the stock will halt for five minutes. The test, scheduled to last through Dec. 10, only covers stocks in the Standard & Poor's 500-stock index, which doesn't include Diebold. On June 16, Washington Post Co. became the first company to have its stock halted under the rule when its shares briefly doubled,

The point is to avoid scaring off investors. "If people think the market is rigged or does all these weird things," says Terrance Hendershott, an associate professor of finance at the University of California at Berkeley's Haas School of Business, "why would people choose to put money in the markets to help firms grow and raise capital?" *—Joshua Gallu and Jesse Westbrook*

The bottom line *Regulators are struggling to cope with computer trading that causes sudden swings in stock prices, undermining confidence in the market.*

Lending

In a Microfinance Boom, Echoes of Subprime

- **As IPOs approach, a fear of rising defaults in the small-loan business**
- **"Investors aren't fully factoring in the risks"**

Savita Ramesh Rathore stands at the door of her dimly lit workshop in Mumbai's Dharavi slum, filled floor to ceiling with bundles of old clothes, and talks about the cost of her son's wedding last year. "Jewels, clothes, food, the town hall," says Rathore, 50, who makes towels from discarded clothes. She borrowed 30,000 rupees ($647) from moneylenders charging 60 percent interest and took additional loans from friends. Three months ago she got a 10,000-rupee loan from urban lender Hindusthan Microfinance at an interest rate of just over 20 percent to repay some of that debt.



Rathore borrowed 10,000 rupees from a microlender

OPPOSITE, FROM TOP: ANDY FRIEDMAN; TONY DEJAK/AP PHOTO. THIS PAGE: ADEEL HALIM/BLOOMBERG

Rathore is one of 25 million Indians who have taken so-called microfinance loans, often without adequate documentation or collateral, according to research firm Micro-Credit Ratings International. As Hyderabad-based SKS Microfinance plans to become the first microlender in the country to go public, an industry credited with helping alleviate poverty is suddenly provoking comparisons to subprime lenders in the U.S.

"Globally, microfinance is showing characteristics of the Western financial markets before the collapse," says Sanjay Sinha, managing director at Micro-Credit Ratings in Gurgaon. "In the U.S., homeowners were given loans at 120 percent of the value of their properties. In rural India, people are being lent to at 150 percent of the value of their enterprises."

Microfinance firms make loans in poor areas largely shut off from traditional banking services. The past two years have been marked by surging defaults in some countries. Microfinance markets in Nicaragua, Morocco, and Pakistan have seen default levels climb to more than 10 percent, the threshold that marks a "serious repayment crisis," according to a February report from policy and research firm Consultative Group to Assist the Poor.

India, where more than 600 million people live on less than $1.50 a day, is the world's largest microfinance market. Most microfinance loans in India range from 5,000 to 20,000 rupees ($108 to $431), with interest rates ranging from 18 percent to 33 percent. Although Indian microfinance firms have reported bad-loan ratios of about 2.5 percent on average, levels may be higher because some lenders roll over loans to struggling borrowers to avoid defaults, says Micro-Credit's Sinha.

Microfinance lending in India may surge by about 40 percent annually over the next few years, says Sinha. SKS, betting the potential for growth will attract investors, is seeking regulatory approval for an initial public offering. Basix Group, which focuses on poor households in rural areas and provides loans averaging about 3,000 rupees, may sell shares in an IPO next year, says Chairman Vijay Mahajan. Others are likely to follow. Until now, microfinance companies have relied on loans and grants from banks, insurers, and foundations for funding, he says.

Micro-Credit's Sinha worries that growth in the microfinance market is masking an erosion of lending standards that may spark rising defaults. India doesn't have a nationwide system for tracking borrowers' credit histories, making it hard for lenders to check whether clients have multiple loans. "There is significant investor interest in microfinance companies' public issues, but it's being driven by irrational exuberance," says Sinha.

Rural lending can be particularly tricky. "If there's a bad monsoon and the farmers lose their crops, our money can go along with it that year," says Amit Kalokhe, a loan officer at Mumbai-based Hindusthan Microfinance. The firm tries to reduce risk by lending to groups of people rather than to individuals, founder Anil Jadhav says. "That way if one person defaults, others can pay the amount," he says. The 10,000-rupee advance to towel maker Rathore in Mumbai was part of a loan to a group of women, according to the company.

Rathore is already mulling how to finance another major outlay: her 19-year-old daughter's wedding. "Once my present loans are paid off, I know there will be more," she says, looking past the open sewage drains near the two-room home she shares with four family members. "The cycle doesn't end." *—Ruth David*

The bottom line *Rushing to cash in on a growing market, India's microlenders may be handing out money to borrowers who can't afford to repay it.*

The Debt Crisis

Europe's Banks Face A Funding Squeeze

- It's hard for them to sell bonds or borrow from each other
- "There's a lot of mistrust," says a debt strategist

The sovereign debt crisis is making it harder for European banks to borrow money from investors–and each other. Investors are shunning bank debt because they fear the bonds of Greece, Portugal, Spain, and Ireland held by the lenders will plunge in value. European banks held $254 billion in loans to the governments of those four countries at the end of 2009, according to the Bank for International Settlements. Including loans to companies and individuals, the banks' overall exposure to the four countries is $1.58 trillion.

Those numbers have made investors jittery. Bank bond sales slowed in May to the lowest since Lehman Brothers' failure in 2008. The extra yield buyers demand to hold the securities instead of government debt soared to the highest this year, and in early June the cost of insuring bank debt against default nearly matched its record high in March, 2009.

Banks also are wary of each

other. Rather than lend excess cash to their peers, banks have been parking it with the European Central Bank. Europe's lenders deposited a record $450 billion in the ECB's overnight deposit facility on June 9, more than in the aftermath of Lehman's collapse. As a result, inter-bank loans with a maturity of more than one month are "rare and expensive," Brice Vandamme, a London-based analyst at Deutsche Bank, wrote in a note to clients on June 9.

That has led banks to rely on the European Central Bank for funding. They tapped the ECB for nearly $150 billion of seven-day cash at its last weekly tender on June 8. "There is a lot of mistrust," said Christoph Rieger, co-head of fixed-income strategy at Commerzbank in Frankfurt. "Banks are trading with the ECB rather than with each other."

Banks' difficulties in raising money will curb their ability to extend loans to companies and consumers, which could threaten the region's recovery, says Morgan Stanley analyst Huw van Steenis. "Many euro zone countries are dependent on bank lending; thus this is a major issue," he says.

There's no mystery behind the nervousness. The ECB said on May 31 that Europe's banks will have to write down 195 billion euros of bad debt by 2011, on top of the 444 billion euros of writedowns they have already logged, bringing the total to the equivalent of $762 billion. U.S. banks will have written down $885 billion by the end of 2010, the International Monetary Fund said in April.

$254
billion

European banks' loans to Greece, Ireland, Portugal, and Spain as of Dec. 31

For banks, "if you're not a quality borrower, you're not going to get funding from the market until you reduce your loan-to-deposit ratio and shrink your balance sheet," says Simon Maughan, an analyst at MF Global in London. "The credit and bond markets are doing their job. Unless you reform, you'll be stuck on government support for the foreseeable future."
—*Gavin Finch and John Glover*

***The bottom line** Fears about shaky sovereign debt are making it hard for European banks to borrow, potentially harming the region's recovery.*

Bid & Ask

By Ira Boudway



Real Estate

Ward Lay, the son of Frito-Lay co-founder Herman Lay, has put his 180,000-acre ranch in the Patagonia region of Argentina on the market for **$30 million**. Located 75 miles north of the resort city of Bariloche, Estancia Alicura includes a five-bedroom main house, two guest houses, stag-hunting and trout-fishing operations, and the chance to call Ted Turner neighbor.

Cable

$1.4bn

The price Cablevison, the fifth-largest cable provider in the U.S., is paying for Bresnan Communications. The purchase gives New York-based Cablevision a larger foothold in the high-speed Internet market by adding more than 300,000 cable and broadband subscribers in four Western states.



Art Market

A limestone head by the 20th-century Italian sculptor Amedeo Modigliani fetched **$53 million** at auction in Paris. The June 14 sale by Christie's set a record for any work sold at a French auction. The anonymous buyer paid more than 10 times the low estimate for the sculpture.

Insurance

Philadelphia-based Lincoln National sold **$1.1 billion** in notes and stock. The lion's share of the money will go to repay the $950 million federal bailout the company accepted last year. Lincoln purchased a savings and loan late in 2008 to qualify for the government aid, but says it is no longer struggling.

Health Care

Allscripts-Misys Healthcare Solutions offered **$1.3 billion** in stock for the medical software provider Eclipsys. The combined company will capitalize on the $30 billion included in last year's stimulus bill for the adoption of electronic medical records.

Food

$1.3bn

The price that Marfrig Alimentos, Latin America's second-largest beef producer, is paying for Keystone Foods, a major processor. The seller is private equity firm Lindsay Goldberg. The purchase will turn São Paulo-based Marfrig into a supplier of chicken nuggets, hamburgers, and other meat products to McDonald's, Subway, and Campbell Soup.

Technology

Reliance Industries entered India's wireless Internet market by agreeing to pay **$1 billion** for 95 percent of Infotel Broadband, which recently acquired several licenses to provide nationwide service at a government auction. The move puts Reliance's billionaire owner, Mukesh Ambani, in direct competition with his younger brother Anil for the first time since the two split their late father's industrial group in 2005. The siblings scrapped their noncompete agreement last month.



Collectibles

A 64-year-old bottle of Scotch whisky sold for **$37,245** at a Bonhams auction in Edinburgh. The Glenfiddich is one of 61 bottles of its kind. An 1850 Bowmore sold in Glasgow in 2007 still holds the record for a bottle of Scotch at more than $59,000.

Sports



$10k

The New York Jets are cutting the price of about 18,000 seat licenses by as much as 50 percent. For a one-time fee, a license grants the right to purchase season tickets for years to come. Sideline seats that had cost $15,000 have been reduced to **$10,000**. The Jets are moving into a new $1.6 billion stadium this season.

CLOCKWISE FROM TOP: COURTESY HALL AND HALL; BONHAMS/BLOOMBERG; JOE ROBBINS/GETTY IMAGES; CHRISTIE'S/BLOOMBERG


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INSIDE COVER BY JEFF GLENDENNING

50 Top Performers

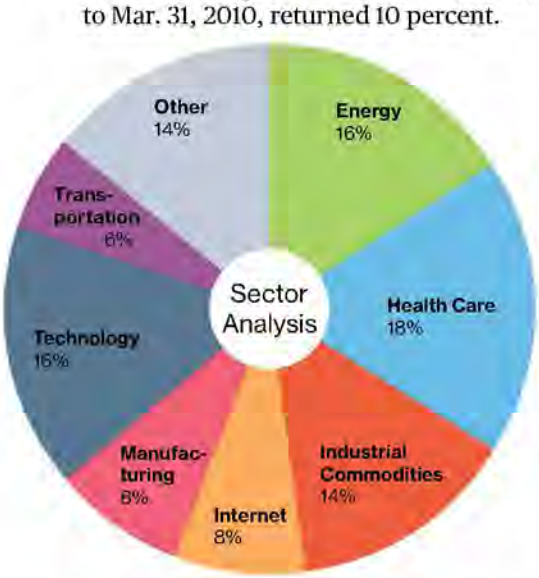
Our ranking of winning stocks in the S&P 500 highlights the resilience of U.S. companies

By Richard McGill Murphy

As chief executive officer of Union Pacific, the country's biggest freight train network, Jim Young hauls everything from Gulf Coast chemicals to California chardonnay along his company's 32,000 miles of railway. Young's weekly traffic reports closely mirror the U.S. economy. In the spring of 2009, Union Pacific moved as few as 133,000 loaded freight cars a week, down from a peak of 204,000 in 2007. Now the weekly cargo tally regularly tops 165,000.

Young, a 32-year railroad veteran, is realistic about the outlook for 2010 and beyond. "The slope of the line will be positive," he says. "But it's not a steep slope. It's going to stay tough until employers start hiring again."

Cautious optimism: You may feel it, too, as you read the corporate profiles in the coming pages. In this issue, we present the Bloomberg Businessweek 50, our ranking of the 50 top-performing stocks in the Standard & Poor's 500-stock index over the past five years. In a period of tremendous economic turbulence, these stocks returned an aggregate 222.3 percent to shareholders, including reinvested dividends. Those who invested $10,000 in this portfolio five years ago and kept it there would have $32,250 in their pockets today. The S&P 500 index, over the same period from Mar. 31, 2005, to Mar. 31, 2010, returned 10 percent.



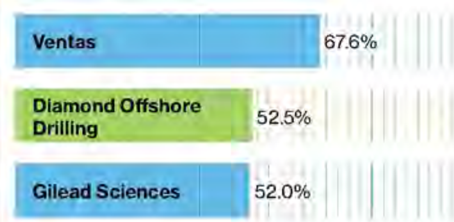
The Bloomberg Businessweek 50 is a reminder of the American economy's ceaseless ability to renew itself. Strongly represented are old-line companies, including Union Pacific (No. 44), Peabody Energy (No. 49), and Cliffs Natural Resources (No. 9), all of which date back to the 1800s. The forces of innovation powered others up the ranks, from Apple (No. 4) and Google (No. 16) to biotechnology players such as Celgene (No. 13) and Gilead Sciences (No. 26), a leader in drugs to fight HIV.

The big surprise on our list is at the top. No. 1: Priceline.com. This online discount travel agency nearly died in the dot-com bust and again in the aftermath of the terrorist attacks of September 11, 2001. Thanks to the management smarts of CEO Jeffery R. Boyd, who took over the top job in 2002, the company reinvented itself and went on to score a total return of 911.9 percent for shareholders over the past five years.

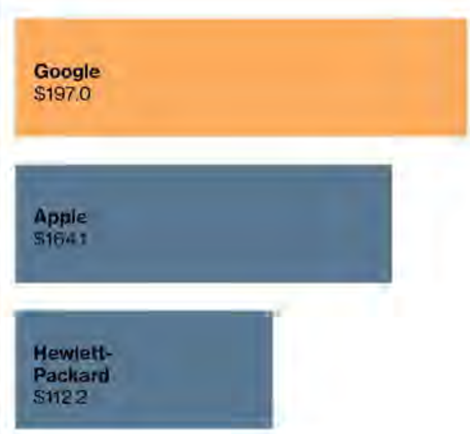
What goes up can always come down, so there's no guarantee any company on the Bloomberg Businessweek 50 will be there in five years, or even in 2011. The companies in our ranking vary dramatically by size, from midcap salesforce.com (No. 5) to behemoths such as Hewlett-Packard (No. 28), the largest company on the list, with sales of $114.6 billion. On a percentage basis, it's harder for big companies to generate incremental growth, which helps explain why so many large, successful U.S. corporations didn't make our cut.

Conversely, growth stocks are more prone to volatility. That makes the long-term success of our smaller superstars even more impressive. Regardless of market value, all 50 companies made the list by honing competitive edges through good times and bad.

Top 3 Companies by Operating Margin



Top 3 Companies by Market Cap
(as end of 2009 fiscal year, in billions)



Top 3 Companies by Revenue (in billions)



1

Priceline.com

E-Commerce	
PCLN	
5-year return	911.9%
2009 revenues	$2.3 billion
2009 net income	$489.5 million

Not so very long ago, Priceline.com found itself unceremoniously grouped into the pantheon of dot-bombdom. In 2001, a mere four years after its founding, everything was falling apart at the quirky travel discounter. A foray into name-your-own-price groceries and gasoline had gone expensively awry, burning through cash at a time when Wall Street was in no mood to provide new funding. Alongside the Pets.com sock puppet and day traders forced to move back in with Mom and Dad, Priceline's wacky television commercials, featuring actor William Shatner of *Star Trek* fame, became caricatures that defined a moment when even the goofiest idea seemed like a financial juggernaut. The company's stock collapsed from a split-adjusted high of $974 in April 1999 to less than $7 in October 2002; to get the share price up, management had to seek a reverse 1-for-6 split.

Beam yourself to 2010, however, and Priceline is in clover. The stock has jumped 27 times from its low, to $185; $10,000 invested in Priceline in March 2005 would have been worth more than $101,000 exactly five years later. Shatner's spots not only are still running, they're so ubiquitous that he says people recognize him more often as Priceline's melodramatic pitchman, the "Negotiator," than as the iconic Captain Kirk. The Norwalk (Conn.)-based outfit is No. 1 on the Bloomberg Businessweek 50—our list of the 50 best-performing stocks on the Standard & Poor's 500-stock index. Alongside eBay and Amazon.com, Priceline, now sporting a market valuation of $8.8 billion, is one of the few old-time dot-com darlings thriving into the 2010s.

Few would have predicted Priceline's success when the September 11 terrorist attacks upended the entire travel industry and threw the company's very existence into doubt. The unlikely comeback owes largely to Jeffery H. Boyd, a lawyer who joined Priceline as general counsel from Oxford Health Plans in 2000. When he became chief executive officer in 2002, Boyd knew the company had to play down its reliance on plane tickets; Priceline's notoriously circuitous take-it-or-leave-it terms—think Miami to San Diego via a six-hour layover in Milwaukee—would be an even harder sell if people weren't flying. So he raced to rebuild the brand around hotels and expand into Europe. The decisions "to focus on hotels and ultimately to take that focus internationally are the steps



ILLUSTRATION BY ANDY FRIEDMAN

that really created the value that our shareholders have realized over the last several years," says Boyd, 53.

The year 2002, which saw a mass extinction of e-commerce outfits, marked the turning point. Priceline's net loss more than doubled to $19 million, the company fired almost 20 percent of its staff, and its stock price fell 73 percent. Airlines were in crisis mode, with the slump in tourism sending United Airlines and US Airways spiraling toward bankruptcy. The outlook for lodging, though, wasn't as bleak. Hotel competitors were setting prices all over the map, and Priceline created a niche for itself by catering to budget-conscious travelers during the downturn.

To relaunch Priceline in 2003, Boyd returned to Shatner, who had largely been shelved as company spokesman. The new campaign had Shatner narrating scenes of travelers comparing the favorable savings they could get on rooms from Priceline vs. those from Expedia and Travelocity. "Ordinarily, the process is Priceline discusses with me the concept and they hope that I'll be able to think of amusing ways of doing it," Shatner says. (So yes, he's improvising.)

Priceline had cultivated relationships with such heavy-hitter hotel chains as Marriott and Starwood before going public in 1999. With that foundation in place, Boyd doubled down on accommodations. Between 2003 and 2004, Priceline consolidated control of Dallas-based Travelweb, a joint venture owned by the major hotel chains. By the end of 2003, Priceline customers had access to more than 10,000 hotels—and the company was building a positive industry reputation. "Suppliers want to work with them and therefore they invariably get the best terms," says Marriott Senior Vice-President Shafiq Khan, who meets with Boyd at least two or three times a year. "It really does competitively put them in a different category than the others." As a result of Boyd's efforts, in 2003 Priceline turned its first annual profit and the stock jumped 86 percent.

Priceline cannily started its overseas expansion in Europe, where spur-of-the-moment travel was more entrenched

It was time to expand overseas. Boyd started in Europe, where spur-of-the-moment discount travel was more culturally entrenched. The CEO moved quickly to exploit two trends: Europeans were booking travel online less often than Americans, leaving a bigger opportunity for growth as they migrated to the Internet. And big hotel chains were not as dominant in Europe, creating fewer price blocs and a competitive opening for smaller players. "In every [European] market there's a large number of independent hotels that benefit from the kind of online distribution we can offer," says Boyd. "That fragmentation is what makes Europe so great for us."

Rather than build from the bottom, Boyd went on an acquisition spree, rolling up existing online discount travel sites. In 2004, he purchased Britain's Active Hotels, an online discount booking agency, for $161 million. A year later, he paid $133 million for Netherlands-based Bookings, now Booking.com. Two years after that, Europe went from a negligible portion of Priceline's revenue to generating more than half of the company's bookings. It helped, of course, that Priceline had banked enough cash during the dot-com boom to sustain itself through a multiyear reinvention.

After success in Europe, Asia beckoned. In 2007, Priceline spent $16 million—plus up to $142 million in incentives—to acquire Agoda.com, a Bangkok-based online travel company that specializes in discount hotel bookings across Asia as well as Australia, the Middle East, and Africa. The deal was targeted at providing more hotel inventory to customers traveling to Asia from Western markets and tapping the region's bustling growth. Asia now represents less than five percent of Priceline's bookings, but it's one of the company's fasting-growing markets.

Overall, international bookings made up 61 percent of Priceline's 2009 total, far more than Expedia and Orbitz, which reported international bookings at 34 percent and 14 percent of their respective totals. Priceline's revenue has grown at least 24 percent each of the past three years. In a show of its countercyclical mettle, it increased sales by 34 percent during the 2008 recession. Last year, net income more than doubled to $489.5 million on revenues of $2.3 billion.

Boyd wins kudos in the industry for pulling all this off through quiet consensus-building and by holding together a solid team. His chief information officer, Michael Diliberto, marketing head, Brett Keller, and president of North American travel, Chris Soder, have all been with the company since Boyd joined in 2000. "Jeff has kept Priceline focused and he has kept some really strong people there," says Henry Harteveldt, a travel analyst at Forrester Research who has followed the company for more than a decade.

Priceline now works with a network of more than 100,000 hotels in over 90 countries—and Boyd sees further room for expansion. In Asia and other developing markets such as South America, there will be a "growth in the absolute number of people that have the wherewithal to travel," he says. And even if the financial turmoil in Greece and other European destinations remains a worry, Priceline's revenues are expected to grow 20 percent in 2010, compared with 11 percent at Expedia and 4 percent at Orbitz. If the past few years are any indication, maybe, just maybe, bad times aren't that bad for Priceline. —*Ari Levy and Roben Farzad*



LARSEN & TALBERT/ICON INTERNATIONAL. OPPOSITE PAGE, FROM LEFT: PRICELINE; BRAD TRENT

Charlie Rose Talks to William Shatner

He played Captain Kirk, Denny Crane of *Boston Legal*, and a zillion other roles—yet many know Shatner best as the pitchman for Priceline.com

How did this association with Priceline begin?
A friend of my wife asked her if it would be all right if this small startup got in touch with me. I was on my way to New Zealand to film and had no idea what a dot-com was or how you order online. They wanted to do some radio spots, just use my voice—no person recognition or anything like that. So finally the deal was sealed, and it was for a couple hundred dollars—a very, very small amount of money. Apparently the spots worked for them. Then one day shortly thereafter they said, "You know, we're going to do television, and we want to start a campaign."



The story is, you took stock options.
Well, this was a very small company, and they said, "Here's what we'll pay you." And I said, "Well, look, that's not anywhere near enough." They explained what the company was, and it all sounded good, so I said, "I'll take stock." Although I'm a business major out of McGill University, I know nothing ... but then I found out much later in life, nobody knows anything.

I find that every day.
It's all by guess and by golly, anyway. And I guessed right. So I watched Priceline.com go roaring from pennies to $150, and I thinking, "I'm rich! I'm rich! In a year and a half I'll be rich! In six months I'll be rich!" Then in three months, I'm less rich. In two months, I'm not rich. In one month, it was less money than it had started out. It had gone up and down in that dot-com bust. So it was money I never had that I lost.

But you stuck with it?
Well, the company looked like it was going under but didn't. So many dot-com companies were formulated on air. Even though the stock had descended into the depths, the business was making a connection with the audience, and slowly—and then not so slowly—the stock went back up. But by that time I had sold.

You sold the stock at what point?
I don't remember. I made some money, but nothing like what I would've have had I held onto it.

There are stories out there that you'd made hundreds of millions.
Would that I had had the sagacity.

So how do they pay you now? Cash, stock, or none of my business?
Well, they trundle up with an armored car. Three guys with Gatling guns. No, they pay me like anybody else.

What's the connection between Shatner and the world that makes people want to use Priceline?
Every so often we change the campaign. So we changed the campaign about four years ago to this Negotiator. And I approached the Negotiator character like an actor. I thought, "The Negotiator is insane." We've made him so nuts that he'll do anything to get a customer a bargain. And that seems to have resonated.

Do they worry that their public identification is with one man?
I know—they must be shivering in their pants. I, on the other hand, stand erect and proud.

So do they come and say, "You be a good boy, Bill"?
No, they come on their knees. They crawl, and I, with great dignity, lift them up: "Be not afraid, my friend. I'll make you proud and will not take advantage of you—at least not to the degree somebody else would have."

Did you have anything to do with Nimoy [Mr. Spock] being in one ad?
Poor Leonard. I recommend him for anything. I put him on the dole.

Have you ever used Priceline?
All the time. That name-your-own-price stuff really works.

So no matter how rich, no matter what advantages, we all love a bargain?
Absolutely, because most of us who have made some money didn't come from money. And that thought is always there: "What would Dad have said?" B



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.


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2

Intuitive Surgical

Health-Care Products	
ISRG	
5-year return	665.6%
2009 revenues	$1.1 billion
2009 net income	$232.6 million

The first mover in the computer-assisted surgery market, Intuitive sells $1 million-plus systems that let surgeons remove tumors by looking at a monitor while guiding tiny scalpels and needles attached to robotic arms. That might seem to epitomize the runaway costs associated with U.S. health care (and a recent botched surgery in New Hampshire brought unwelcome headlines), yet CEO Gary Guthart, 44, argues that his systems allow surgeons to work more efficiently, producing better outcomes and less trauma. "In the end it saves money," he says.



3

Southwestern Energy

Oil & Gas
SWN
5-year return 473.9%
2009 revenues $2.1 billion
2009 net income (-$35.7 million)

This domestic natural gas exploration and production company scored big five years ago when it discovered a rich field in Arkansas that today generates 2 percent of the yearly gas production in the U.S. Southwestern recorded a net loss in 2009 due to a writeoff that reflected last year's natural gas price plunge. Although the company posted a profit in the first quarter, CEO Steve Mueller recently reduced his 2010 earnings forecast because of weather-related operational delays and continued soft pricing. Long-term, Mueller is upbeat: "As we move away from a hydrocarbon economy, gas is by far the cleanest way to bridge that gap."

4

Apple

Electronics
AAPL
5-year return 463.8%
2009 revenues $42.9 billion
2009 net income $8.2 billion

In late May, Apple's market cap hit $222.1 billion–surpassing Microsoft's and valuing The House That Steve Built at No. 2 in the U.S. after Exxon Mobil. Sales of iPhones account for nearly half the stock's value, says Boston analytics company Trefis.





5

salesforce.com

Software
CRM
5-year return 396.7%
2010 revenues* $1.3 billion
2010 net income* $80.7 million

CEO Marc Benioff (above) pioneered the market for Web-based enterprise software when he founded salesforce.com in 1999. Its customer relationship management (CRM) software helps companies share data regarding sales, service, and marketing operations. Benioff says the next computing trend will involve the integration of enterprise software with social networks. His first salvo: Chatter, a set of Facebook-like tools due to be released June 22, will allow users to collaborate and share data in real time. Salesforce recently acquired Jigsaw, an online business service whose users can access each others' business contacts. "By combining CRM with business contact data, we can create an incredibly sticky experience," Benioff says.

*Fiscal 2010 ending Jan. 31.

CLOCKWISE FROM TOP LEFT: PHOTOGRAPH BY TODD TANKERSLEY FOR BLOOMBERG BUSINESSWEEK; ILLUSTRATION BY ANDY FRIEDMAN; PRICELINE

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6

Express Scripts

Pharmaceuticals

ESRX

5-year return
366.8%

2009 revenues
$24.7 billion

2009 net income
$827.6 million

Pharmacy benefits manager Express Scripts handles prescription drug coverage for health insurers and employers, including the U.S. Defense Dept. To reduce costs and increase profits for clients, CEO George Paz has been applying the principles of behavioral economics to encourage smarter consumer practices such as mail-order prescriptions.

7

Flowserve

Diversified Machinery

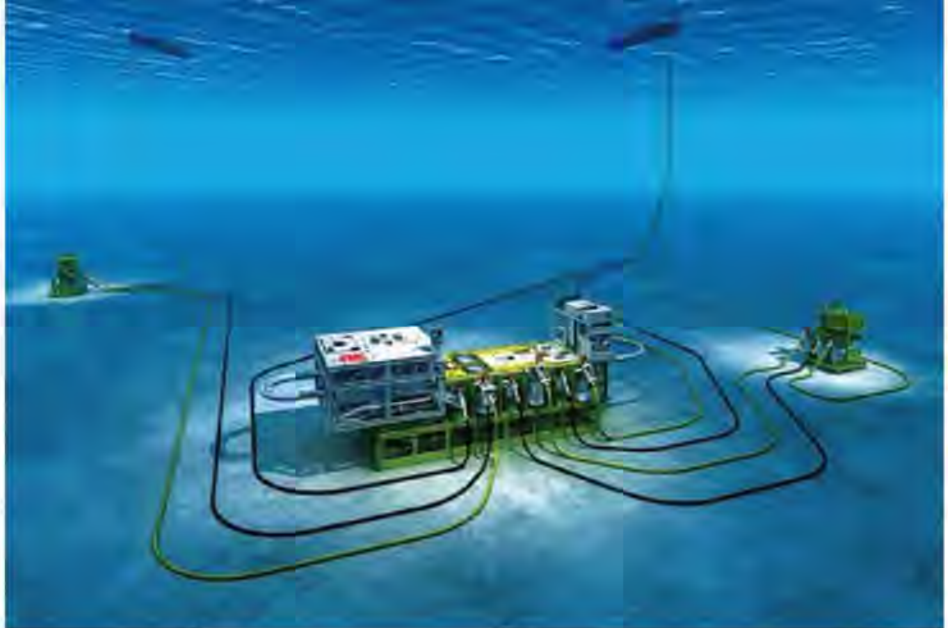
FLS

5-year return
342.2%

2009 revenues
$4.4 billion

2009 net income
$427.9 million

Flowserve has thrived by selling and servicing valves, pumps, seals and other machinery for energy producers. Now CEO Mark A. Blinn's Irving (Tex.)-based company stands to benefit from the Obama Administration's proposed subsidy increases for nuclear energy production.



8

FMC Technologies

Oil & Gas Services	
FTI	
5-year return	310.4%
2009 revenues	$4.4 billion
2009 net income	$361.8 million

With strong demand for its subsea drilling and production technology, FMC Technologies has capitalized on the offshore boom. Now it may have to contend with a post-BP offshore bust. Although demand is expected to slow in the short term because of the federal moratorium on offshore drilling, CEO Peter D. Kinnear recently raised his earnings estimate for 2010, citing strong overseas demand and higher margins in the subsea business.

FMC's subsea separation system (painting, above) off Rio de Janeiro

9

Cliffs Natural Resources

Iron & Steel

CLF

5-year return
306.9%

2009 revenues
$2.3 billion

2009 net income
$205.1 million

Chinese demand has fueled growth at North America's No. 1 iron ore producer. With iron and steel prices rebounding after a weak 2009, CEO Joseph A. Carrabba expects more than $1.5 billion in cash from operations in 2010.

10

Amazon.com

Internet

AMZN

5-year return
296.1%

2009 revenues
$24.5 billion

2009 net income
$902 million

Amazon's sales surged 28 percent last year. Despite the challenge from Apple's iPad, CEO Jeff Bezos seems confident future growth will be driven by sales of electronics (including the Kindle e-reader) and general merchandise, which now account for nearly half of total revenues and are expanding three times faster than sales of books and other media.

11

Titanium Metals

Mining

TIE

5-year return
278.6%

2009 revenues
$774 million

2009 net income
$34.5 million

This Dallas-based titanium supplier had a weak 2009 coming off several years of sales growth fueled by aerospace demand. CEO Bobby D. O'Brien is optimistic about 2010, thanks to more stable commercial aerospace inventory levels and a strengthening global economy.

12

Cummins

Diversified Machinery

CMI

5-year return
278.3%

2009 revenues
$10.8 billion

2009 net income
$428 million

The diesel engine maker is reaping the benefits of CEO Tim Solso's expansion into emerging markets, including China, India, and Brazil. The company reported sales of $2.48 billion in the first quarter of 2010, up 2 percent from 2009. North American revenues fell 27 percent, but that dip was offset by brisk sales overseas.

FMC TECHNOLOGIES; OPPOSITE PAGE: ILLUSTRATION BY ANDY FRIEDMAN; PHOTOGRAPH BY DAN FORBES FOR BLOOMBERG BUSINESSWEEK; SHATNER: PRICELINE

13

Celgene

Biotechnology	
CELG	
5-year return	263.9%
2009 revenues	$2.7 billion
2009 net income	$776.7 million

Thalidomide was understandably vilified in the 1960s because it induced birth defects. Celgene CEO Sol J. Barer, 63, has built his company (which began as the biotech group within chemical maker Celanese before it was spun off in 1986) around new, benign applications for the drug. Celgene's Thalomid is used to treat a complication of leprosy as well as myeloma, a blood cancer. The company, which makes drugs to combat other cancers, expects 25 percent sales growth this year.





14

DeVry

For-Profit Education
DV
5-year return 248.2%
2009 revenues $1.5 billion
2009 net income $165.6 million

A for-profit university with 90 locations in the U.S. and Canada, DeVry offers associate, bachelor's, master's, and online degrees in fields from computer science to nursing. Students, many of whom complete four-year programs in three years, pay fees comparable to those at leading state universities, says CEO Daniel Hamburger (above). Tuition and fees for a BA in business cost $21,230 a year over three years.

15

Precision Castparts

Metal Components
PCP
5-year return 231.7%
2010 revenues $5.5 billion*
2010 net income $921.8 million*

A maker of fasteners, castings, and other components for jet engines, gas turbines, and industrial metalworking, Precision Castparts saw sales drop 19 percent in the fiscal year ending Mar. 31, 2010, because of a slump in aerospace demand. Revenues are projected to rise 10 percent in fiscal 2011 as Boeing rolls out its Dreamliner and airlines resume modernizing their fleets.

*Fiscal 2010 ending Mar. 31.

16

Google

Internet
GOOG
5-year return 214.1%
2009 revenues $23.7 billion
2009 net income $6.5 billion

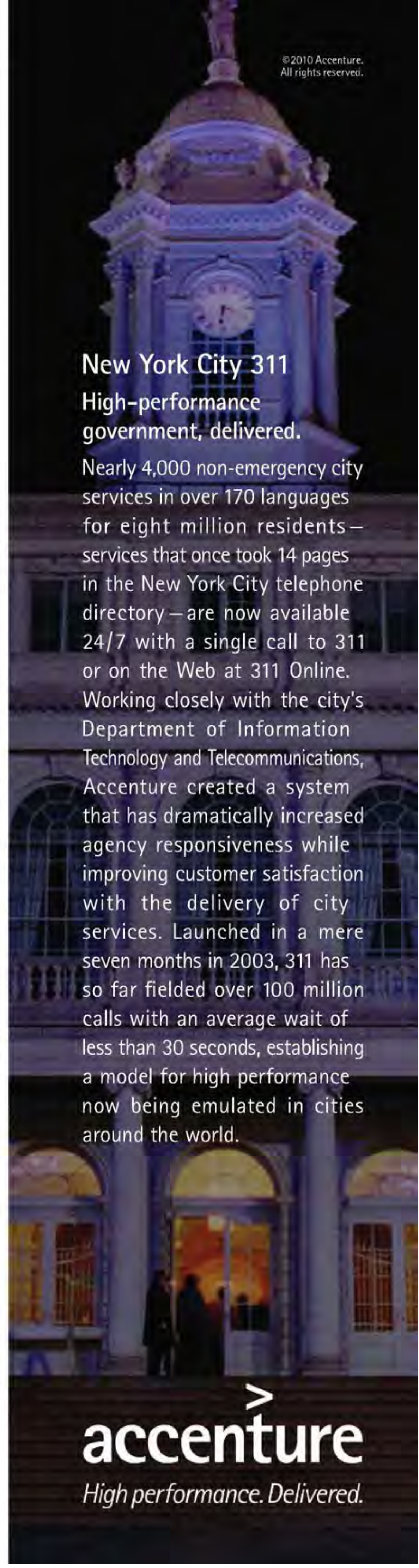
The search giant recently acquired AdMob, an ad sales platform for mobile devices, for $750 million. As Google's Android smartphone takes on Apple's iPhone, CEO Eric Schmidt aims to extend his advertising dominion from online to mobile.

17

Range Resources

Gas Exploration & Production
RRC
5-year return
206%
2009 revenues $840.4 million
2009 net income (-$53.9 million)

Range has outperformed all other U.S. gas companies, with a stock price up 2,500 percent in the past decade, because of finds such as the giant Marcellus Shale in Pennsylvania. Gas prices are now low, and Range took a net loss in 2009 after a noncash asset writedown due partly to the closure of a plant, but CEO John Pinkerton is bullish thanks to his company's rich reserves.



18

Western Digital

Computers

WDC

5-year return
205.8%

2009 revenues
$7.5 billion

2009 net income
$470.0 million

More businesses are using the launch of Microsoft's Windows 7 operating system as an excuse to replace old PCs–and the world's No. 2 hard drive manufacturer (after Seagate) is cashing in. CEO John Coyne announced second-quarter gross margins of 25.2%.

19

Big Lots

Retail

BIG

5-year return
203%

2010 revenues*
$4.7 billion

2010 net income*
$200.4 million

Big Lots caters to bargain-hunting Americans. The company, led by retail veteran Steven S. Fishman, uses its purchasing muscle to buy excess inventory from makers of toys, housewares, and other goods, passing the savings on to customers at 1,400 stores. In the first quarter of 2010, Big Lots' same-store sales rose 6 percent over the first quarter of 2009.

*Fiscal 2010 ending Jan. 31.

20

Cameron International

Oil & Gas Services

CAM

5-year return
199.7%

2009 revenues
$5.2 billion

2009 net income
$475.5 million

Cameron International, which built the failed Blowout Preventer on the Deepwater Horizon rig, faces lawsuits and a swooning stock price. But only 5% of CEO Jack Moore's oil-field equipment revenues come from the Gulf of Mexico, and global demand for Cameron's deepwater drilling services is expected to remain strong. "We anticipate that any lull in [oil industry] capital spending will be short-lived," Standard & Poor's analyst Stewart Glickman wrote in a recent note on Cameron.





21



Airgas

Chemicals	
ARG	
5-year return	181%
2010 revenues*	$3.9 billion
2010 net income*	$196.3 million

The country's largest distributor of medical, industrial, and specialty gases has one sweet business, with compound annual growth of 18.6% over the past five years. It's also a personal success story for CEO Peter McCausland (above), who founded Airgas in Radnor, Pa., in 1982. (He's one of seven founder CEOs on the Bloomberg Businessweek 50, along with Celgene founder Sol Barer, salesforce.com's Mark Benioff, Amazon.com's Jeff Bezos, Apple's Steve Jobs, designer Ralph Lauren, and NVIDIA cofounder Jen-Hsun Huang.)

By acquiring some 400 local gas distributors over 28 years, McCausland made Airgas the biggest national player in what had been a regional industry. Airgas now controls about 25% of the U.S. industrial gas distribution market. Competitors include Praxair and Airgas's bigger, Allentown-based rival, Air Products, which had revenues of $8.3 billion in 2009. "In the early days we concentrated on running the local businesses really well," says McCausland, 59. More recently Airgas has built a Web-based gas distribution platform, helping national clients save money by cutting out local middlemen. "Our willingness to change has been the key to our success," he adds.

Until the recession, the company had never experienced a down year in its core gas sales and container rental business. Gas and rent revenues dipped 10 percent in the fiscal year ending Mar. 31, and sniffing weakness, Air Products launched a hostile takeover attempt last October. The Airgas board has rebuffed Air Products, arguing that its offer price (currently $7 billion in cash, including $1.9 billion in assumed debt) undervalues the company.

How does it feel to be on the receiving end of a takeover attempt after acquiring so many companies? "Every one of our acquisitions was friendly," McCausland says. "This whole thing has shined a bright light on Airgas, showing the market how undervalued we were."

*Fiscal 2010 ending Mar. 31.

FROM TOP: ILLUSTRATION BY ANDY FRIEDMAN; U.S. COAST GUARD; LARSEN & TALBERT/ICON INTERNATIONAL

22
Red Hat

Software

RHT

5-year return
168.3%

2010 revenues*
$748.2 million

2010 net income*
$87.3 million

The world's largest Linux provider, Red Hat, did well in the downturn as companies took a second look at affordable open-source solutions. CEO Jim Whitehurst, 41, who joined in 2008 after leading Delta Airlines out of bankruptcy, is aiming for Red Hat's sales to hit $1 billion by 2012.

*Fiscal 2010 ending Feb. 28.

23
CSX

Transportation	
CSX	
5-year return	163.8%
2009 revenues	$9 billion
2009 net income	$1.2 billion

Jacksonville (Fla.)-based CSX has the largest freight rail network in the Eastern U.S. and has dramatically improved its on-time performance and safety record in recent years under CEO Michael Ward. U.S. rail shipments dipped last year, but Ward expects them to recover in 2010 and beyond.


DANIEL ACKER/BLOOMBERG

24
Medco Health Solutions

Pharmaceuticals

MHS

5-year return
160.5%

2009 revenues
$59.8 billion

2009 net income
$1.3 billion

With Chief Executive David Snow at the helm, Medco has boosted earnings sharply over the past three years. The country's largest pharmacy benefit manager expects to profit from growing mail-order prescription volumes and a wave of popular drugs like Fosamax going off patent. Wall Street also likes Medco's robust cash flow, which should yield strong growth in earnings per share.

25
Occidental Petroleum

Oil & Gas

OXY

5-year return
159%

2009 revenues
$15.4 billion

2009 net income
$2.9 billion

Under longtime CEO Ray R. Irani, 75, Occidental has become one of the most profitable oil and gas producers around. Last year the company boosted output by 7 percent, to a record 645,000 barrels of oil equivalent per day, and replaced 206 percent of its global reserves. Oxy hit its highest-ever year-end stock price ($81.35 a share), up 36 percent over 2008.

26
Gilead Sciences

Biotechnology

GILD

5-year return
154.1%

2009 revenues
$7 billion

2009 net income
$2.6 billion

Led by CEO John C. Martin, Gilead dominates global HIV medication markets and recently entered the cardiovascular therapy arena via several acquisitions. Martin lowered Gilead's 2010 revenue estimate to reflect anticipated cuts in Medicare and Medicaid reimbursements as a result of health-care reform. Still, the company has promising HIV combination therapies in the pipeline.

27
BMC Software

Software

BMC

5-year return
153.3%

2010 revenues*
$1.9 billion

2010 net income*
$406.1 million

BMC grew by acquisition and today sells systems management software to giant customers such as AT&T. CEO Robert E. Beauchamp anticipates growing demand for BMC's Web-based computing services.

*Fiscal 2010 ending Mar. 31

28
Hewlett-Packard

Computers

HPQ

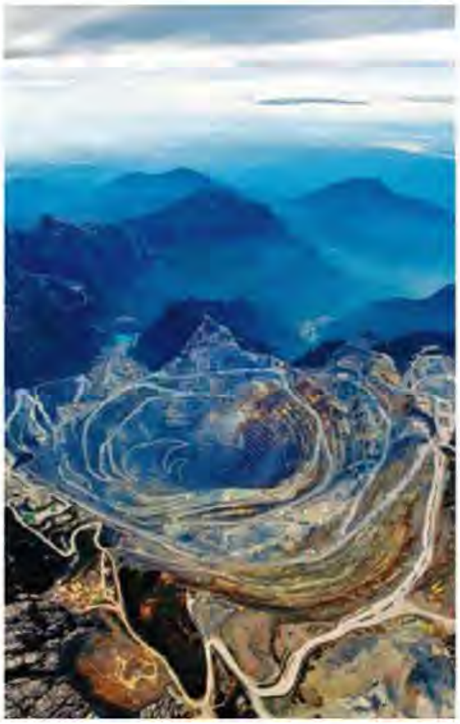
5-year return
152.8%

2009 revenues
$114.6 billion

2009 net income
$7.7 billion

Defying the Law of Large Numbers, CEO Mark Hurd has led Hewlett-Packard to significant revenue gains off a gigantic base in recent years. Post-recession, HP's imaging, printing, and services divisions all stand to benefit from pent-up consumer and business demand.





Indonesia's Grasberg mine (top), operated by Freeport, holds vast gold and copper reserves

29

Quanta Services

Commercial Services	
PWR	
5-year return	151.1%
2009 revenues	$3.3 billion
2009 net income	$162.2 million

Quanta builds power, natural gas, and telecom networks. Since 2007, two key acquisitions have spurred growth in the company's gas and fiber-optic units. After a slow first half, CEO John R. Colson predicts new business will accelerate late in the year.

30

Freeport-McMoRan Copper & Gold

Mining	
FCX	
5-year return	150.4%
2009 revenues	$15 billion
2009 net income	$2.7 billion

The world's largest publicly traded copper producer has benefited from China's rising demand. Although prices have slumped since hitting a 20-month high in April, and Freeport's shares are down 28 percent since the start of 2010, CEO Richard Adkerson is investing $100 million this year to explore for mineral deposits. In the first quarter of 2010, Freeport reported total sales of $4.4 billion, up 69 percent from the same period last year.

31

McDonald's

Retail	
MCD	
5-year return	146.8%
2009 revenues	$22.7 billion
2009 net income	$4.6 billion

McDonald's returned 16 percent to its shareholders in 2009, No. 1 in the Dow Jones industrial average. The compensation of CEO Jim Skinner, 65, was also supersized: $17.61 million, mostly in performance bonuses. Skinner gets credit for expanding the chain's Value Meals in the recession. Keeping growth alive during the recovery may be an even bigger test.



32

Akamai Technologies

Internet	
AKAM	
5-year return	146.7%
2009 revenues	$859.8 million
2009 net income	$145.9 million

Akamai is the Internet's air traffic controller. With Web Goliaths such as Amazon.com as customers, Akamai software routes their data to the best or closest server on its proprietary network, ensuring users speedy delivery of content.

33

Stericycle

Environmental Control	
SRCL	
5-year return	146.6%
2009 revenues	$1.2 billion
2009 net income	$175.7 million

In 1992, Mark Miller left a CEO-track career at Abbott Labs to run medical waste disposal firm Stericycle, a money-losing Chicago business with about $1.5 million in revenues. He launched an ambitious rollup strategy, acquiring some 170 small medical waste disposal companies in the U.S. and abroad. Like other health-care companies on our list, Miller expects Stericycle to benefit from the expanded U.S. market created by health-care reform and can head to the office each day free from worry about market volatility. "You probably don't schedule a blood test based on what the stock market is doing," says Miller.

FROM TOP: JEZ O'HARE/FMI; PHOTOGRAPH BY DAN FORBES FOR BLOOMBERG BUSINESSWEEK



34

Ventas

REITS	
VTR	
5-year return	145.2%
2009 revenues	$935.3 million
2009 net income	$266.5 million



An owner and manager of hospitals, nursing homes, and personal-care facilities across the U.S., Ventas has sparkled in recent years, returning 39 percent to shareholders in 2009 and 2,000 percent over the past decade. By that measure the Chicago-based real estate investment trust outperformed all publicly traded financial companies, including banks, insurance companies, and other REITs.

It helps to be in health care, a rare growth sector during the recession, though CEO Debra Cafaro (above), 52, gets credit for smart financial management. "In 2007 we thought we were going into a dangerous financial period," she says. So the company fortified its balance sheet by selling assets, reducing debt, and raising $1.1 billion in equity. The moves paid off when S&P awarded Ventas an investment-grade credit rating in 2008. Cafaro continued to execute her conservative strategy through 2009, increasing bank lines of credit, raising more equity, and minimizing acquisitions. Last year Ventas enjoyed an operating margin of 67.6 percent, the highest of all companies in the Bloomberg Businessweek 50.

Ventas' performance is especially remarkable in the context of a real estate crash that dragged down the entire stock market. "Our assets performed well, and we showed strong fundamental cash flows," Cafaro says. "But in the stock market we were really thrown in with all the other financial and REIT stocks." From a low of $18.37 on Dec. 1, 2008, Ventas' shares have rebounded to trade around $48. Noting that baby boomers start becoming eligible for Medicare in 2011, Cafaro is bullish.

35

Millipore

Biotechnology

MIL

5-year return
143.3%

2009 revenues
$1.7 billion

2009 net income
$177 million

After years of success selling laboratory equipment to biotech companies, Millipore recently sold itself to Germany's Merck (which is unrelated to Merck in the U.S.). CEO Martin D. Madaus says the $7.2 billion all-cash deal is scheduled to close on July 14.

36

Allegheny Technologies

Iron & Steel

ATI

5-year return
138.3%

2009 revenues
$3.1 billion

2009 net income
$31.7 million

In recent years Allegheny has shed its commodity steel roots to concentrate on higher-margin specialty metals such as titanium for jet engines. After a dire 2009, CEO L. Patrick Hassey announced strengthening demand across most segments in the first quarter of 2010.

FROM LEFT: ILLUSTRATION BY ANDY FRIEDMAN; LARSEN & TALBERT/ICON INTERNATIONAL



37

FMC

Chemicals	
FMC	
5-year return	135.8%
2009 revenues	$2.8 billion
2009 net income	$229.8 million

When he took over in January, CEO Pierre Brondeau inherited a financially healthy company with an operating margin of 16.5 percent in 2009. The Frenchman assumed the reins at Philadelphia-based FMC from William G. Walter, who will retire as chairman later this year after 36 years at the company, which sells everything from insecticides to lithium in markets worldwide. In late March FMC shares soared by more than 12 percent after management announced that first-quarter 2010 earnings would exceed 71¢ a share, beating analysts' estimates. FMC's profits on industrial chemicals are expected to rise as demand firms going forward.

Transplanting rice treated with FMC pesticide in Andhra Pradesh, India



38

Diamond Offshore Drilling

Oil & Gas Services

DO

5-year return
134.5%

2009 revenues
$3.6 billion

2009 net income
$1.4 billion

The Houston-based contractor's rig bookings may fall this year due to the federal moratorium on drilling in the Gulf, but CEO Lawrence Dickerson forecasts strong demand for its services in 2011. In recent years Diamond has spent much of its cash on special shareholder dividends rather than fleet modernization, which could hurt competitiveness.

39

DirecTV

Media

DTV

5-year return
134.5%

2009 revenues
$21.6 billion

2009 net income
$942 million

The country's largest satellite pay TV network moved past rival Dish Network with popular programming such as NFL Sunday Ticket. Under new CEO Michael White—he moved over from PepsiCo International in January—DirecTV is generating plenty of cash but faces stiff competition from cable TV providers such as Verizon and AT&T.

40

C.H. Robinson Worldwide

Transportation

CHRW

5-year return
134.1%

2009 revenues
$7.6 billion

2009 net income
$360.8 million

Thanks to lean operations, proprietary technology, and a gigantic client base, this global shipping broker is taking the lead in its industry. The recession squeezed C.H. Robinson's margins, but CEO John Wiehoff announced strong revenue growth in the first quarter of 2010.



41

American Tower

Telecommunications	
AMT	
5-year return	133.7%
2009 revenues	$1.7 billion
2009 net income	$246.6 million

Under CEO James Taiclet, a former U.S. Air Force pilot, one of the largest owners of cell-phone towers in America has also been expanding in Brazil, Mexico, and India.

42

Monsanto

Chemicals	
MON	
5-year return	132.8%
2009 revenues	$11.7 billion
2009 net income	$2.1 billion

In late May, CEO Hugh Grant cut Monsanto's earnings forecast for the fiscal year through August by 21 percent because of a price drop in its signature Roundup line of agricultural herbicides. Monsanto had built up a strong market position by selling Roundup together with genetically engineered seeds. Now the herbicide has come off patent and is under price pressure from generic Chinese equivalents. Roundup-resistant weed strains are also beginning to sprout on U.S. farms.

43

Amphenol

Electronics	
APH	
5-year return	130.1%
2009 revenues	$2.8 billion
2009 net income	$317.8 million

One of the world's largest manufacturers of electronic connectors and coaxial cable, Amphenol's advanced technology has made it the most profitable company in its niche. Under CEO R. Adam Norwitt, the company endured soft demand during the recession but now stands to benefit from telecom infrastructure expansion worldwide.



44

Union Pacific

Transportation	
UNP	
5-year return	127.9%
2009 revenues	$14.1 billion
2009 net income	$1.9 billion

Vast scale, efficient operations, and a diverse product mix helped the nation's biggest freight rail network power through the recession. Although construction-material shipments remain weak, UP announced strong growth across most segments for the first quarter, even though CEO Jim Young (above) believes that the U.S. economic recovery will be slow. "It's a long ways before anyone says this thing is over," he says.



45

Noble Energy

Oil & Gas	
NBL	
5-year return	123.5%
2009 revenues	$2.2 billion
2009 net income	(-$131 million)

CEO Charles Davidson posted a net loss on weak oil and gas prices in 2009 after coining money in earlier years. Still, Noble's global footprint and strong exploration record (notably its participation in Israel's biggest natural gas discovery, as well as rich discoveries in the Galapagos Islands and Equatorial Guinea) bode well for future returns.

46

Polo Ralph Lauren

Apparel	
RL	
5-year return	123.0%
2010 revenues*	$4.97 billion
2010 net income*	$479.5 million

Polo Ralph Lauren is the only luxury company in the Bloomberg BW 50. In recent years, Polo took direct control of Asia/Pacific distribution and boosted e-commerce sales. The stock soared by 87 percent in the 12 months to April 2010 on improving demand and better-than-expected earnings forecasts for the first quarter. Analysts caution that the company's growth prospects are limited by intense competition and continued weakness in consumer spending.

*Fiscal 2010 ended Apr. 30.



OPPOSITE PAGE: FMC CORPORATION; CLOCKWISE FROM TOP LEFT: AMERICAN TOWER; ILLUSTRATION BY ANDY FRIEDMAN; PHOTOGRAPH BY DAN FORBES FOR BLOOMBERG BUSINESSWEEK; PRICELINE


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If you innovate,
they will come.
• Consulting • Technology • Outsourcing

47

Cognizant Technology Solutions

Computers

CTSH

5-year return
120.7%

2009 revenues
$3.3 billion

2009 net income
$535 million

Cognizant is the youngest of the big Indian IT outsourcing firms, competing with Infosys, Wipro, and IBM in the business software and services arena. Led by CEO Francisco D'Souza, the Teaneck (N.J.)-based company, founded in 1994, is heavily exposed to the financial services sector, which accounts for 46% of revenues. Nevertheless, it has grown rapidly on its blend of offshore outsourcing with local consulting.

48

NVIDIA

Semiconductors

NVDA

5-year return
119.4%

2010 revenues*
$3.3 billion

2010 net income*
(-$3 million)

The computer-graphics chipmaker has long dominated the high end of its market. But Nvidia lost money in its 2010 fiscal year, ending Jan. 31. (Semiconductor industry revenues dipped by 9 percent in the 2009 calendar year.) Co-founder and CEO Jen-Hsun Huang faces brutal competition from Advanced Micro Devices and Intel in the graphics market, but he's finding new customers among makers of high-performance computers that use his chips to supercharge their powerful machines.

*Fiscal 2010 ending Jan. 31.

49



Peabody Energy

Coal	
BTU	
5-year return	116.6%
2009 revenues	$6.0 billion
2009 net income	$448.2 million

The world's largest private-sector coal company says it fuels 10 percent of all the electricity generated in the U.S. and 2 percent worldwide. Most of the 244 million tons that Peabody mined in 2009 came from Wyoming's Powder River Basin and the Midwest, but the company's mining interests extend as far as China, Australia, and Mongolia.

Coal provides just over a quarter of global energy needs, says the industry-funded World Coal Institute. Peabody CEO Gregory H. Boyce (above), 55, is a proponent of "clean coal" technology, still under development, which separates and stores the carbon dioxide emitted during coal combustion.

Under Boyce, Peabody has taken a 6 percent equity stake in GreenGen, a 650-megawatt coal plant and R&D facility in Tianjin, southeast of Beijing. Greengen will produce hydrogen for fuel cells using coal gasification technology and carbon storage. Chinese authorities valued the company's expertise in surface mining (most mainland coal comes from deep mines). "We bring surface mining, land reclamation, and safety expertise into the Chinese context," Boyce says. He expects demand from China and India, as well the U.S. and Australia, to fuel growth. But to safeguard his company's future, he has to solve the carbon problem.

50

Amerisource-Bergen

Pharmaceuticals

ABC

5-year return
114.9%

2009 revenues
$71.8 billion

2009 net income
$503.4 million

AmerisourceBergen distributes branded and generic drugs and related products to doctors, hospitals, and pharmacies. Thanks in part to strong generic drug sales, CEO R. David Yost expects 8 to 10 percent revenue growth in 2010.

[the end]



2-50: *Company profiles by Richard McGill Murphy*

FROM LEFT: ILLUSTRATION BY ANDY FRIEDMAN; LARSEN & TALBERT/ICON INTERNATIONAL



In a recent Accenture survey, 89% of executives agreed that innovation is as important as cost management. See how we're helping one of the world's leading companies maximize their return on innovation.

Marriott

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• Corporate Strategy
• Growth Strategy
• Operational Strategy
Sustainability
• Sustainability Regulation & Strategy
• Sustainability Operational Excellence
• Emissions Management
• Sustainable Infrastructure
Customer Relationship Management
• Marketing Transformation
• Sales Transformation
• Customer Service Transformation
Finance & Performance Management
• Corporate Finance
• Finance Operations
• Enterprise Performance Management
Risk Management
• Risk Organization & Governance
• Risk Strategy & Process
• Risk Analytics, Reporting & Data Management
Process & Innovation Performance
• Operations Performance
• Process Performance
• Innovation Performance
Supply Chain Management
• Supply Chain Strategy & Planning
• Sourcing & Procurement
• Manufacturing & Fulfillment
• Service Management
Talent & Organization Performance
• Human Capital & Organization Effectiveness
• Human Resources & Talent Management
• Learning & Collaboration
• Change Management
Business Process Management
Predictive Analytics
• Industry-specific
• Functional & Cross-functional
Interactive
• Digital Marketing
• Marketing Analytics
• Media Management
Technology
IT Strategy
Application Development & Management
• Microsoft
• Oracle
• SAP
• Open Source
• Java
• Custom & Industry Solutions
Infrastructure
• Data Center Technology & Operations
• Workplace Technology
• Network Technology
Security
Cloud Planning, Transition & Implementation
Descriptive Analytics
• Business Intelligence
• Portals & Content Management
• Data Management & Architecture
Mobility
• Applications
• Machine to Machine
• Managed Services
Outsourcing
Business Process Outsourcing
• Customer Contact
• Engineering
• Finance & Accounting
• Human Resources & Learning
• Supply Chain & Procurement
• Industry-specific & Custom Services
Application Outsourcing
• Application Development & Management
• Testing Services
• Capacity Services
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• Data Center Services
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SAAB LIVES

... At least for a while. After years of mismanagement by GM, the odd little Swedish carmaker has an even odder new owner and two short years before it has to start making money. By David Welch and Ola Kinnander

ILLUSTRATION BY STEVE CAPLIN

Saab Chairman Victor Muller smiles and pushes his BlackBerry across the table. On its screen is the image of a silver, teardrop-shaped car he calls the 92, a zippy compact that recalls the spirit of the embattled Swedish company's rebellious early days. The original 92 was a beloved racer on the European Rally circuit in the 1950s. The new one may be the key to Saab's future. If it has one.

"I designed this car myself," says Muller, whose boutique sports-car maker Spyker Cars—which hand-builds about 40 automobiles each year, selling them for $219,000 and up—acquired Saab from General Motors in February for a total $400 million in cash and preferred stock. Muller wants his dream car to communicate the air of genteel nonconformism that Saab aficionados once adored. It's his antidote to the GM era, when Saab subsisted on hand-me-down models from Opel, Subaru, and Chevrolet, and was almost shuttered last winter before Muller finally prevailed. "I want to erase the memory of those cars," he says. "Saab needs to go back to its roots."

There's just one problem. To build the 92, Muller says, "we need $320 million and a car platform from someone else." He and his 900 engineers and designers at Saab headquarters in Trollhättan, Sweden, may understand precisely what Saab loyalists want. Now they have to find a way to make money in order to turn that vision into reality. Otherwise the future runs out two years from now.

Saab lost $570 million in 2009. The company has $200 million in cash and another $480 million in loans from the European Investment Bank. GM gave Saab another $326 million in exchange for preferred stock (and will forgive another $175 million in cash obligations), pushing Saab's total purse up to around $1 billion—small change in the car business. GM, for instance, has $36 billion cash on hand.

Muller will spend one-fifth of his modest war chest to market the new flagship 9-5, a sporty, true-to-the-brand sedan (never mind that it was designed by GM in Germany). It goes on sale this month in Europe and next month in the U.S. Next year he rolls out the 9-4X, a not especially Saab-like SUV based on the hot-selling Cadillac SRX. After that, he has to ready his Trollhättan plant to build a new model 9-3, a smaller sedan and, in its current turbocharged convertible form, arguably the only Saab now being sold that's worthy of the name. It used to sell in decent numbers—until Saab teetered near death last year and prospective buyers fled.

The company's cash gives it until 2012 before it needs to start generating new money for engineering and marketing. By then, Muller says, he plans to triple sales from the paltry 40,000 cars sold worldwide last year. That would bring sales close to the 2006 record of 133,000. If he can hit that target, Saab will be able to earn "a couple hundred million a year in profit," Muller says. He claims it won't be too hard. Saab just needs to reach former customers who have deserted the brand in the 10 years since GM acquired all of the company. Muller figures if he can get 3 percent of the 4.5 million people who once owned a Saab, he can sell 120,000 a year.

Saab Chairman Muller at the Trollhättan (Sweden) headquarters in December after offering to buy the carmaker from GM



"I want to erase the memory of those cars," says Muller. "Saab needs to go back to its roots"

Resurrecting a battered brand is tough enough; doing so as a tiny, independent company in an industry dominated by conglomerates is close to impossible. "I don't see how a small company like Saab can make a go of it," says IHS Global Insight analyst John Wolkonowicz. "They don't have the infrastructure or the big sales volume." Industry kingpins such as Renault-Nissan Chief Executive Officer Carlos Ghosn and Fiat-Chrysler CEO Sergio Marchionne agree that carmakers need volume to generate billions for new technology and fresh models. So Renault-Nissan has forged a deal with Germany's Daimler to develop small cars and clean engines. Toyota has teamed with Tesla Motors to build electric cars. Ford and GM jointly develop transmissions. The day he announced that Spyker had bought Saab, Marchionne said at an industry conference in Stockholm, "I like the Saab brand, but I think it's very difficult to be a niche player and be profitable."

One niche carmaker that managed to claw its way back from irrelevance is Audi. Owned by Volkswagen since 1964, the brand was beaten down in the U.S. during the 1980s by a succession of poorly received models and highly publicized quality problems, including sudden acceleration. After annual U.S. sales fell from 74,000 to less than 20,000 in 1991, Audi cut prices, addressed the safety issues, and started rolling out new models that people wanted to buy, says James N. Hall, principal of 2953 Analytics, a Birmingham (Mich.) consulting firm. The Volkswagen Group could afford to be patient while Audi won buyers back. "Saab doesn't have the luxury of being a part of a big seller," Hall says. "Audi lost money in the U.S. while they were establishing the brand." Today, Audi sells about 1 million cars a year globally, maintaining a distinct identity even though it shares platforms and technology with its corporate cousins.

GM's 20-year stewardship of Saab, by contrast, is a case study in brand dilution. For Saab, sharing parts, engines, and chassis with other GM cars meant losing character. The 9-7X SUV was a Chevy Trailblazer with a better grill; Saab pur-

BOBBO LAUHAGE/ALL OVER PRESS/POLARIS

ists mockingly called it the Trollblazer. The 9-2X was a Subaru WRX (GM owned 20 percent of Subaru parent Fuji Heavy Industries until 2005), and won the nickname "Saabaru." Neither sold well. Even Saab's two mainstay models– the 9-3 and 9-5–were watered down by GM. The 9-3, once a distinctive hatchback, was remade as a generic sedan. The 9-5 had some real flavor but fell out of fashion during 13 years without an overhaul.


Spyker's pristine factory in Zeewolde, the Netherlands

What GM squandered was a specific brand consciousness–a mix of proud Nordic originality and sweet technology–that led many Northeasterners to buy multiple Saabs and drive them for hundreds of thousands of miles. Turbochargers and tight steering made them fun. Hatchbacks and front-wheel drive made them practical. And oft-remarked oddities–the ignition switch between the front seats, a "night panel" switch that shuts down the dashboard except for the speedometer–only hinted at the idiosyncratic Saabishness that some people came to love.

Saab began as Svenska Aeroplan Aktiebolaget in 1937 and began making cars in 1947. After entering the U.S. market in 1957, with the 93, the brand became known for weirdly aerodynamic cars with small, two-cycle engines that required owners to add oil directly to the gas tank. You had to work a little harder to drive a Saab–and to some it was worth the effort. "Those engines were powerful for their size," says Ian Glenday, president of the Saab Club of North America. He bought a 1959 model 93B in 1963 and drove it for five years; he has since bought 10 more Saabs. His first had a pull chain in the cabin that would raise a barrier, cutting air flow to the engine to help it warm up and heat the cabin more quickly. To an electrical technician living in frigid Plattsburgh, N.Y., at the time, that was a nicely engineered bonus. "It wasn't pipe-smoking college professors who got Saab started here," Glenday says. "It was people in technology industries who understood what Saab had done."

After GM announced plans to close Saab last winter, workers and fans took to the streets



The cars were offbeat, practical, and safe. The original 92 was a small car that could "seat five Swedes," says Stephen Goldberger, treasurer of SCNA. Legendary Saab rally racer Erik Carlsson used to roll the 92 over during races, climb out, roll it back on its wheels, jump in, and keep driving.

The Saab 900, introduced in 1978, brought the brand some cachet in the States. Saab moved it upscale compared with other models; in 1980 the car sold for almost $14,000, a $6,000 premium over the 99. It was more stylish and better-appointed and still had plenty of turbocharged pep, says Wolkonowicz of IHS Global Insight. Saabs were a hit with New Englanders because they drove better in snow than the rear-drive sedans that American carmakers were building. But the 900 reached a different audience. "Saab was always embraced by iconoclasts," Wolkonowicz says. "Saab brought in some Yuppies with the 900, especially the 900 convertible." And some eggheads. More than 42 percent of Saab customers have an advanced degree, a higher proportion than any other luxury brand, according to J.D. Power & Associates.

GM bought half of Saab in 1990 and the rest in 2000, and started sharing Opel parts in the mid-1990s, Hall says. The cars' steering and suspension got softer on the road. "GM wanted more volume, but to do that they diluted the Saab character," he said. "As GM owned more of Saab, the cars became less Saab."

In 2005 the company slipped into crisis. As GM's balance sheet collapsed it raced to cut costs, delaying or cancelling new models. The new 9-5 was eventually put on hold. Marketing budgets also suffered. Saab had enough momentum from the 9-3, launched in 1998 and redesigned in 2003, to sell a record 133,00 cars in 2006. Models like the 9-2X and 9-7X flopped. The lack of investment resulted in a sales decline to 94,751 in 2008. By 2009, GM put the brand on the block.

GM designers realized the company's mistake and began trying to put the Saab back into Saab. The new 9-5 that Spyker inherited from GM has the tight handling the brand used to be known for, says Hall, who has driven the car. Its interior is luxurious but understated. It still has the night switch and between-the-seats ignition. And it was designed and engineered by Opel at its headquarters in Russelsheim, Germany, by a team led by an American and a Brit, says retired GM Vice-Chairman Bob Lutz. They carefully incorporated Saab cues like the 900's curved windshield and remembered to install the turbocharger as well. "We worked very hard to make it a real Saab," Lutz says.

By then, however, the global financial crisis was threatening GM's existence. Saab was one of four brands marked for sale or death. It was given up for dead so many times, Muller says, that many potential buyers have no idea it's still alive.

Muller grew up in Amsterdam, up the street from a Saab dealer; he recalls watching the company's 96 sedan buzzing by. He trained as a lawyer and began

FROM TOP: COURTESY OF SPYKER CARS; BOBBO LAUHAGE/ALL OVER PRESS/POLARIS

his career in 1984 at the Amsterdam office of global law firm Baker & McKenzie. In 1989 the fair-haired, gregarious Dutchman joined the management team of offshore company Heerema, later taking part in a management buyout that made him president of a Dutch harbortowage and marine-salvage company, Weismuller Holding. Along the way he built up a formidable collection of vintage automobiles—a 1958 Ferrari 250 GT, a 1928 Rolls-Royce Phantom 1 Experimental Jarvis—and traveled the world showing it off. In 1998 he met Maarten de Bruijn, a speedboat builder who had designed and produced a sports car and was looking for a partner. The next year the pair acquired the Spyker brand, which had been founded in 1898 but went out of business in the 1920s. They used the name to start a super sports-car company making hand-built, street-legal racers. Spyker's best year was 2006; the company sold 74 cars. Last year it sold 36.

Spyker has never made money, and its tiny production scale and boutique assembly plant has little to offer a company that wants to build and sell 120,000 cars a year. At its plant in rural Zeewolde, the Netherlands, the white floor is pristine and the shop is quiet; there's no feverish workforce, no clanking assembly line. Mechanics remove their shoes before climbing into one or another of the nine sleek Spykers that are in the plant for service from clients from Russia to Britain. The ambience is about as industrial as a high-end spa. "We create art objects," says Spyker sales manager Peter van Rooy. "You don't do that by throwing together cars in a filthy, smoky hall."

When the financial crisis hit and nearly every carmaker in the world went into the red, Muller got to thinking about Saab. He wasn't a Saab nut—he'd owned only one, not nearly enough to qualify—but figured the brand's affluent, well-educated clientele made the car worth saving. When a consortium led by Swedish sports-car maker Koenigsegg Automotive backed out of a deal with GM in November 2009, Muller sent an e-mail to Lutz saying he wanted to buy the brand. Lutz responded within eight minutes.

Spyker emerged as the frontrunner, and on Dec. 17, Muller and lawyers for GM and Saab gathered in Stockholm to sign the documents. Then GM dropped a bomb: It had suddenly decided there was "no point in carrying on" with the deal. GM Vice-President John Smith declined to elaborate, saying only that Saab would be wound down. It soon emerged that GM's sticking point was Vladimir Antonov, the Russian banker who was Spyker's chairman and biggest shareholder, with a 29.9 percent stake. GM's specific concerns with Antonov have never been publicly explained. His father, banker Alexander Antonov, was shot five times and seriously wounded in Moscow in March 2009. Vladimir Antonov has consistently denied any criminal ties, and in February he complained in a *New York Times* op-ed that he was pushed out of the Saab deal because of his nationality.

Many potential customers think the company is dead, so Muller plans to spend $180 million on marketing

When GM announced the liquidation, Muller didn't give up. He submitted a new bid, continuing the emotional roller-coaster ride for Saab's 3,500 workers and its fans around the world. The automotive press started a death watch. On Jan. 5, 50 Saab enthusiasts drove 35 Saabs to Detroit, parking in the cold outside GM's headquarters and asking it to sell rather than close the brand—a show of support echoed by Saab rallies in dozens of other countries. Weeks of uncertainty passed, with GM insisting it was closing Saab even as it explored other offers, including one from Formula One tycoon Bernie Ecclestone, who partnered with Genii Capital, a Luxembourg-based private equity firm.

Muller revised his offer. He brought in new investors, taking the Russians out as major shareholders of Spyker. By the end of January, Spyker had reemerged as the leading contender. Muller took breaks from endless negotiations by drawing his 92 concept car (professional designers will take it from there). On Jan. 26, after a final all-night push, GM agreed to sell the Saab brand to Spyker, pending the approval of a critical 400 million euro loan from the European Investment Bank, the European Union's lending arm. The price tag was $74 million in cash and $326 million in preferred shares in the new company, which may change its name to Saab Spyker Automobiles.

At a press conference that night at Stockholm's posh Café Opera, Muller said he had slept a total of 15 hours over the five days it took to wrap the deal. "I think he slept less than that," Jan Olsson, who heads Deutsche Bank's Nordic investment banking activities, told Bloomberg News the next day. "At the press conference last night, he hadn't slept in about 35 hours. He worked all night. He doesn't take no for an answer."

Muller has made believers out of the workers in Trollhättan. "I was definitely

The original Saab 92 rolling off the Trollhättan assembly line in 1950



worried about losing my job," says Petra Storch, 37, who installs seats and interior parts at the plant. "When we got the word that Victor was going to buy Saab I felt so elated. Now we're going to show the world what Saab can do." Saab cognoscenti are heartened, too—at least, the ones who are aware of Muller's plans. To increase awareness, Muller plans to spend $180 million on marketing in the first year. GM spent a fraction of that annually during Saab's sad final years there.

Losing GM as an owner hurts in at least one way. Saab's second-largest market in the U.S., after New England, is the Detroit area, where GM workers took advantage of employee discounts to buy the cars. That market accounted for 15 percent of U.S. Saab sales in 2008, according to Experian Automotive. "We will lose most of those people," concedes Muller.

If Saab needs such subsidies to survive, it won't. Its revival must start with the new 9-5 on sale this month. The car is getting nice reviews from the motoring press; *Car & Driver* called it GM's best Saab. It's also more expensive than the car it replaces, with a $40,000 base price that rises to $55,000 for all-wheel drive and a V-6 engine, says Annette Adams, owner of Iowa City Saab. The old car sold for $39,000 to $45,000.

Getting buyers to pay more than $50,000 for a Saab won't be easy, says Eric Noble, president of The CarLab, an auto industry consulting firm in Orange, Calif. That kind of money will buy you an Audi or a BMW. For Saab to command the same price it will need new infusions of technology. Muller plans to outsource much of Saab's future engineering work. "We know for a fact we can get a good partner who wants to share technology with us," he says. Buying technology from other carmakers is difficult—competitors don't like to part with their best engineering. Says Noble: "Running a carmaker that is heavily reliant on components from the outside is a trail of tears."

Such factors could easily delay the 92, Muller's teardrop-shaped baby, and delay could be fatal. Saab is in talks with BMW about getting engines and platforms from its Mini division to make the 92, two sources familiar with the talks say. No deal has been hammered out. Best case, the new 92 comes out in 2013. By then, Muller says, Saab will surely be alive and well and selling tens of thousands of 9-5s and 9-3s to its old customer base. It's a fairy tale, after all. It ought to have a happy ending. B

—With Jeroen Molenaar in Zeewolde

Saab Loyalists, Test Your Knowledge!
(Clueless outsiders, feel free to play along, too)

1



What year was the elegant Saab 92 introduced?

- (a) 1949
- (b) 1962
- (c) 2006
- (d) None of the above—it's a concept car

2



In 1978 the Saab 900 became an improbable hit with:

- (a) California enviros
- (b) Tennessee whiskey distillers
- (c) New England eggheads
- (d) People who found Volvos just a bit too sexy

3



In 2005, GM sold this sport-utility vehicle. It was called:

- (a) The Chevy Trailblazer
- (b) The Saab 9-7x
- (c) The GMC Envoy
- (d) All of the above

4 Which of these cars is the classic Saab 9-3?

(a)



(b)



5



Introduced in 1998 and updated in 2003, the 9-3 convertible has been one of Saab's best-selling models. How many did it sell last year in the U.S.?

- (a) **1,260**
- (b) **3,235**
- (c) **42,929**
- (d) **124,657**

6



The redesigned Saab 9-5, a worthy successor to this line of iconoclastic cars, first came to market in:

- (a) 2008
- (b) 2009
- (c) 2010
- (d) none of the above—it's a concept car

EXTRA CREDIT



This odd duck is known as the:

- (a) Subaru WRX
- (b) Kia Trailfrog
- (c) Mazda Macchiato
- (d) Saab 9-2x

Answers: 1: a, 2: c, 3: d (those three SUVs, as well as the Buick Rainier, were indistinguishable), 4: b (GM killed the hatchback and went generic in 2002), 5: a, 6: c, Extra Credit: d (the 9-2x "Saabaru" is a copy of the WXR)

OPPOSITE PAGE AND THIS PAGE: COURTESY OF SAAB

LIKE CANDY FROM A BABY

Kenneth Starr is charged with taking money from rich clients and spending it on himself and his fourth wife. How could it have been so easy?

By John Helyar and David Glovin

Kenneth Starr knew how to cultivate relationships with powerful people, and he did it in the most transparent way—by serial name-dropping. According to one occasional lunch companion, dining with Starr at the Four Seasons Grill Room in New York meant listening to him reel off names as fast as he guzzled Diet Cokes. Certain people would come up again and again. According the lunch acquaintance, Starr would say he had lunch with Pete Peterson or that he and Pete were talking at the Council on Foreign Relations—long chaired by Peterson—or that he had done something with Pete.

Starr managed money for a living, and his relationship with Peterson, the co-founder of the private equity firm Blackstone Group, was one of his key assets. Another asset was Rachel "Bunny" Mellon, the 99-year-old widow of the bank heir and philanthropist Paul Mellon, who started Starr on his path to wooing the rich.

His career famously came to an end last month when FBI agents arrived at his home on Manhattan's Upper East Side and found Starr hiding in a closet. His $7.5 million condominium, which he shared with his fourth wife, Diane Passage, a pole dancer, featured floor-to-ceiling windows, a granite lap

Starr met Passage in 2005; he kept pictures on his iPhone of her pole dancing

"white mink coat white mink coat white mink coat" read one of Passage's Facebook postings



pool, and a 1,500-square-foot garden, all allegedly financed with plundered cash. Ten days after his arrest, a grand jury indicted Starr for cheating 11 clients—Jim Wiatt, the former head of the William Morris Agency, and Uma Thurman among them—out of $59 million. Starr allegedly pocketed half that amount, while the other half was placed in investments in which he or his friends had a secret interest. Starr has denied wrongdoing and is being held at the Metropolitan Correctional Center in lower Manhattan.

The Securities & Exchange Commission brought its own civil fraud lawsuit against Starr and Passage, seeking the return of tens of millions of dollars. The two haven't yet responded to the SEC. A judge last week extended the freeze on the couple's assets at a hearing attended by Passage, who looked uncharacteristically demure in a pink Vivienne Westwood cardigan and a black skirt. She declined all reporters' questions except for one from *Bloomberg Businessweek*, about her age: "Thirty-four," she said. "You can take a couple of years off that if you want to."

The disintegration of Starr & Co., which once managed more than $700 million for about 175 wealthy individuals, exposes an uncomfortable truth about the elite crowd he preyed on—that these wealthy, supposedly sophisticated people could be such easy marks for fraud. The numbers involved are not on the scale of Bernie Madoff, but Starr shared Madoff's ability to create an aura of exclusivity around himself that appealed to the elite—which was augmented by Starr's attendance at prestigious business gatherings, such as Allen & Co. President Herbert Allen's annual media conference in Sun Valley, Idaho.

Still, there was no special trick to Starr's alleged con game. How is it so many people so willingly allowed their pockets to be picked?

"Everyone follows the herd," says Ken Springer, a former FBI agent and founder of New York-based investigative firm Corporate Resolutions. "Everyone says this guy is the best, and no one vets the people."

Starr's connections to Blackstone go back to the early 1990s when the firm was considerably smaller than it is now. According to a lawsuit filed in 2009 by the estate of former Starr client Joan Stanton, the investment firm received $90 million from clients of Starr & Co. The actor Wesley Snipes, for instance, put $1 million into Blackstone, according to testimony in the actor's 2008 tax-evasion trial.

Starr and Peterson grew close enough to create and co-invest in a tech venture fund. It proved to be a dud

Injecting himself as a middleman, Starr both charged clients for placing their money with the firm and pooled their investments in partnerships he controlled. The Stanton estate's suit decried "excessive fees," which came on top of Starr's regular ones, that rose from $120,000 a year when Stanton hired him in 1987 to $228,000 in 2004. The suit also accused Starr of using the partnerships to prevent Stanton from having direct communication with Blackstone.

Stanton committed $5.1 million to a fund called Blackstone Domestic Capital Partners II, which didn't go straight to that firm but joined other Starr clients in a $12.4 million pool he formed called Blackstone Partnership Investment Fund. Stanton's Blackstone returns were supposed to go to a trust whose assets would be distributed tax-free to heirs. Instead, the suit charged, the Blackstone returns went to purposes unknown.

By 1996, Starr and Peterson had grown close enough to create and co-invest in a tech venture fund called P.S. Capital Holdings. Two of the managers were Richard Kimball, then Peterson's son-in-law (he and Peterson's daughter Holly divorced in 2009), and Ronald Starr, a son from Ken Starr's first marriage. The fund's investment pool was $13 million.

As Internet fever spiked around the year 2000, P.S. Capital morphed into the more ambitious Millennium Technology Venture Fund, which raised $160 million of investor capital, yielded more than two dozen technology startups, and included "special limited advisory partners" Peterson and Starr. Dan Burstein, a veteran tech hand and Peterson protégé, was recruited from Blackstone to run Millennium.

Its location in the same office building as Starr & Co. enabled Starr to shuttle easily between the two offices, although personnel matters were apparently not his strength. A former Millennium secretary named Mystery Masiello filed a discrimination lawsuit against the company in 2003, alleging that when she told the firm's leaders she was pregnant in

PREVIOUS PAGE: CHANGE YEH/PATRICKMCMULLAN; THIS PAGE: ANDREW HARRER/BLOOMBERG/GETTY IMAGES

Starr directed $90 million of investments to Peterson's Blackstone Group in the early 1990s



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July 2001, Starr said, "Oh great, now Dan [Burstein] is going to have to get a new assistant." The case was settled on undisclosed terms in 2003.

The Millennium fund, launched just before the Internet bubble burst, proved to be a dud. Its few successes—such as the Internet security company Phobos, which was sold to SonicWALL in 2000—were overshadowed by big losses. About half of the original $160 million has been returned to investors, according to a person familiar with its finances, and Millennium is in the process of being wound down.

"They were caught up in the Oklahoma land rush" along with many other Internet investors, says Neil Livingstone, former chief executive officer of GlobalOptions Group, a security company. GlobalOptions, which was the Millennium Fund's only nontech investment and its top-performing portfolio company after the bubble burst, went public in 2005. But it owed much of its success to business it received directly from Millennium. "We shut down a lot of their Silicon Valley companies," says Livingstone, who is now CEO of Washington security firm ExecutiveAction.

The firm was an early example of Starr's growing propensity to invest client funds "in questionable and suspicious investments, often with a direct benefit to himself, his wife," or friends, prosecutors said last month in Starr's criminal complaint. Starr also put his clients' money straight into GlobalOptions stock. In a February 2008 SEC filing by GlobalOptions, Thurman and playwright Neil Simon together were listed as owning nearly as many shares (422,127) as the company's CEO Harvey Schiller (426,801).

In 2004, Millennium was reinvented by Burstein as Millennium Technology Value Partners, a provider of liquidity for distressed tech companies in exchange for equity stakes. In its new incarnation it has had some success, investing in companies that were later bought by Amazon.com, Microsoft, and AT&T, and in April it closed a new $280 million fund to new investors. Starr was listed on the Millennium website as a "special limited advisory partner" until February 2008, but according to people familiar with the firm, he effectively ceased involvement when Burstein changed the concept. Peterson remains a special advisory partner.

Millennium distanced itself from Starr in a June 4 letter to investors, obtained by *Bloomberg Businessweek*: "He has not been actively involved in any operational or strategic decision-making capacity with the Fund for many years now," Burstein wrote. "We believe there has been no negative impact on the Fund or its investments to date as a result of Mr. Starr's alleged activities and we anticipate there will be no negative impact in the future."

"If you have a bigger yacht than your clients, they won't trust you," Starr liked to say

Starr met Bunny Mellon when he was a young CPA with the Manhattan accounting firm Oppenheim, Appel, Dixon & Co. The Bronx-born graduate of Queens College and Brooklyn Law School loved the idea of handling taxes for one of America's richest families. He absorbed his clients' methods and desires, though he dressed inexpensively himself, inspired by Paul Mellon's maxim: "If you have a bigger yacht than your clients, they won't trust you."

The Mellons led Starr to another big-fish Oppenheim client, Arthur Stanton, who made his fortune as the first U.S. distributor of Volkswagen Beetles and who lived at one of Manhattan's finest addresses, 10 Gracie Square. Stanton's apartment served as a salon to many of the city's elite. Stanton's wife, Joan, was an actress who had played Lois Lane in *The Adventures of Superman* radio show, and their home was often filled with performing artists. When their daughter, Jane, turned 21, Leonard Bernstein led the singing of *Happy Birthday*. Arthur Stanton introduced Starr to his social circle and endorsed his accounting. Film director Mike Nichols and stage director Hal Prince became Starr clients.

Arthur Stanton died in 1987, leaving $60 million to his widow, and Starr pitched himself to manage it for her. A lawsuit brought against Starr by Joan Stanton's estate 22 years later, soon after her own passing at age 94 in May 2009, portrayed him as a predator who defrauded her of "tens of millions of dollars."

"Mrs. Stanton's lack of financial acumen was known to Mr. Starr," the complaint said. "Mr. Starr began to cultivate Mrs. Stanton as a client who would come to rely on his services exclusively." Starr left Oppenheim in 1987 to start his own firm, and the skills he'd honed on the Mellons and Stantons served him

ALLEGED VICTIMS



Diane Sawyer and Mike Nichols
Hal Prince
Neil Simon
Uma Thurman
Wesley Snipes



Starr divorced previous wife, and former secretary, Marisa in 2007

well in building a larger clientele. A person who has known him professionally for years says Starr was a master of ingratiating himself with people. He wasn't suave; he wasn't a Madoff in appearance and charm; he was rather abrupt. So what was the appeal? This person describes Starr as very bright and says he came across as sincere. He could sit down with a piece of paper and map out detailed investments.

Starr's reputation took its first public beating in 2002 when his client Sylvester Stallone sued him for keeping him invested in Planet Hollywood from 1997 to 2001, as the restaurant chain spiraled toward bankruptcy and the value of his 4 million shares withered. The actor accused Starr of putting his friendship with Keith Barish, a founder of Planet Hollywood, ahead of his fiduciary duty to clients, and sought at least $10 million in damages. The litigation, settled on undisclosed terms in 2003, was an example, prosecutors say, of Starr's habit of making investment decisions without his clients' approval.

In 2006, Starr formed Starr Investment Advisors; filings indicate he had 26 to 100 clients and 11 to 50 employees. Starr placed $6.5 million of Bunny Mellon's fortune into two investment funds from 2005 to 2007 without informing his longtime client that they were "highly speculative and risky," according to prosecutors. He also failed to "disclose certain conflicts of interest." Only in August 2009, when investigators asked Mellon's attorney about these illiquid investments, did her representative become aware of the funds. Starr returned $4.3 million to Mellon that month.

Starr's behavior outside the office also turned erratic, apparently coinciding with the start of his relationship with Diane Passage in 2005. Over the span of a few months in 2006 he bought more than $400,000 of jewelry from Jacob & Co., aka Jacob the Jeweler, according to the criminal complaint. In May 2007 he divorced Marisa Starr; according to her 2009 lawsuit, he did so by filing court documents without her knowledge that claimed she agreed to end 16 years of marriage. Starr's fourth wife was a flashy, jarring presence in Manhattan society—tattooed, provocatively dressed, and proud to be a pole dancer. Starr was proud of her, too, showing iPhone pictures of her gyrating on a pole to acquaintances.

Some clients were disturbed by Starr's spending on Passage. In early 2008 he recruited Jacob the Jeweler, whose real name is Jacob Arabo, as an investment client. His money was invested in "sure deals," according to the criminal complaint, that included Glassnote Entertainment Group, which gave Passage a $150,000-a-year job, and Martin Bregman Productions, a movie venture involving Marty Bregman, who was a Starr client and a veteran producer of films like *Scarface*. Passage wanted to make the film version of *The Desert Rose*, Larry McMurtry's novel about an aging Las Vegas showgirl. The two doomed ventures represented $1.4 million of the $13 million Arabo lost on Starr investments, according to prosecutors.

The same buzz network that made Starr quickly undid him, as stories of losses and strange behavior spread. Clients were leaving the firm, including Mike Nichols and his broadcaster wife, Diane Sawyer.

Joan Stanton died in May 2009 at age 94. Four months later her estate sued Starr for "gross abuse of trust and confidence" over 20 years. The Stanton complaint, combined with some individual complaints, spurred the Manhattan District Attorney's office and the SEC to start asking questions.

Starr settled with the Stanton estate for an undisclosed sum in January. He also reached a $4 million settlement that month with an unidentified playwright and screenwriter who complained of being fraudulently induced to invest in a failed restaurant chain, according to the lawsuit. Starr allegedly raided other clients' accounts to make the payment. In another winter development, a veteran account manager for Starr named Arnold Herrmann left for rival firm Citrin Cooperman & Co. and took some of his top clients, including Barbara Walters.

As his firm disintegrated, Starr tried to maintain appearances. At a Mar. 10 meeting with federal investigators, he said his firm had 200 clients. At its peak, that would've almost been true, but the list had dwindled to fewer than 40 by the time of his arrest. In April he bought the $7.5 million condominium, and this proved to be the final straw. On May 25, Alexander Forger, the lawyer for Bunny Mellon, Starr's first big client and one of his last, was looking through her financial statements. He saw a series of mid-April wire-transfers out of her Starr & Co. account, totaling $5.75 million. Starr had allegedly raided the account to close on his condominium. Forger called the authorities, and two days later federal agents were removing him from the closet.

OPPOSITE PAGE, FROM LEFT: JON KOPALOFF/FILMMAGIC/GETTY IMAGES; NEILSON BARNARD/GETTY IMAGES; THEO WARGO/WIREIMAGE/GETTY IMAGES; JAMIE MCCARTHY/WIREIMAGE/GETTY IMAGES; LYNN GOLDSMITH/CORBIS. THIS PAGE: MICHAEL LOCCISANO/PATRICKMCMULLAN/SIPA PRESS


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Inside the multi-billion dollar craft brewery business
Page 92

Wealth & Travel & Beer & 4G & Bear Stearns

Etc.



Prepare for the ultimate summer trip
Page 90



The Sweet Smell of Excess

Scent branding is the latest craze in the fragrance industry—and there's nothing subtle about it. *By Spencer Morgan*

Photograph by Bartholomew Cooke

TOP: BRAND X PICTURES/GETTY IMAGES

Etc. Branding

On a recent April afternoon, a limousine carrying two French perfumers from multibillion-dollar, Manhattan-based International Flavors & Fragrances idled in front of a squat, clay-colored building in the South Bronx. The perfumers, Bruno Jovanovic and Pascal Gaurin, had with them a bottle of their newest concoction, L'Eau Vert du Bronx du Sur (translation: the Green Water of the South Bronx) to show Majora Carter, a leading green consultant and neighborhood resident. The perfume wasn't meant for Carter. Its intended recipient was a nearby low-income housing development–the Sister Thomas Apartments. By pumping this specially engineered scent into the building's hallways and common areas, the unlikely threesome believes the 200 residents will be infused with optimism and happiness. "The part of your brain that senses scent can allow you to feel really bad about what you see in front of you–or really good–depending on what it is," she explains. "The question is: How do you evoke a certain feeling without imposing on people in any way?"

The fragrance industry thinks it has the answer. Jovanovic and Gaurin, who are responsible for luxury colognes and perfumes such as Tom Ford Black Violet and Giorgio Armani Onde Extase, are leading the latest fragrance business craze, a form of sensory branding known as "ambient scenting." Jovanovic, 34, helped pioneer the trend by creating the "woody" aroma–a combination of orange, fir resin, and Brazilian rosewood, among others–for Abercrombie & Fitch. Since its roll-out in stores across the country two years ago, Abercrombie's Fierce, which also pervades sidewalks outside the clothier's stores, has become an integral part of the shopping experience. Popular demand compelled the company to produce the trademark *odeur* in bottle form, and, according to Jovanovic, customers have complained when store-bought T-shirts lose the smell after multiple washes.

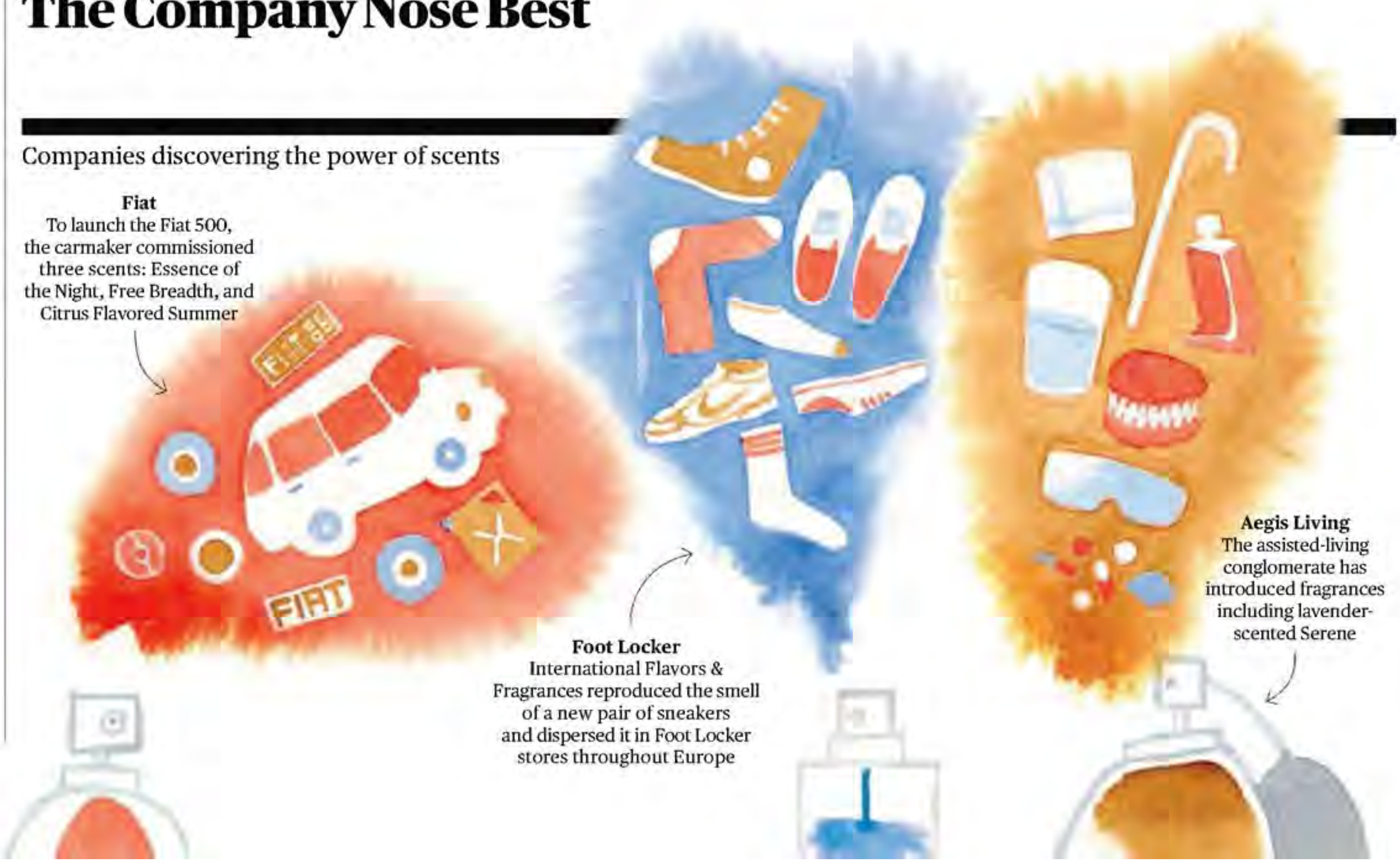
> **The Miami Mandarin Oriental sprays Meeting Sense in conference rooms to increase productivity**

Scenting an entire building is the latest ambition in a growing business that has, for years, gone unnoticed by most consumers. Roger Bensinger, executive vice-president for scent marketing company Prolitec, estimates there are now 20 companies worldwide specializing in ambient scent-marketing and dispersion technology. While many of these companies are privately held, industry executives value the business at roughly between \$80 million and \$100 million. These enterprises typically pair with fragrance companies and share in the scenting and machine maintenance dues, which can range anywhere from \$100 to \$10,000 a month depending on the size of the space to be scented.

No longer confined to lingerie stores, ambient scenting became standard practice in casinos in the early 2000s and invaded the hospitality sector soon thereafter. Sheraton Hotels & Resorts employs Welcoming Warmth, a mix of fig, jasmine, and freesia. Westin Hotel & Resorts disperses White Tea, which attempts to provide the indefinable "Zen-retreat" experience. (Despite its abstraction, the line was successful enough to inspire Westin's 2009 line of White Tea candles.) Marriott offers different smells for its airport, suburban, and resort properties. The Mandarin Oriental Miami sprays Meeting Sense in conference

The Company Nose Best

Companies discovering the power of scents



Fiat
To launch the Fiat 500, the carmaker commissioned three scents: Essence of the Night, Free Breadth, and Citrus Flavored Summer

Foot Locker
International Flavors & Fragrances reproduced the smell of a new pair of sneakers and dispersed it in Foot Locker stores throughout Europe

Aegis Living
The assisted-living conglomerate has introduced fragrances including lavender-scented Serene

ILLUSTRATION BY LOUISE MA

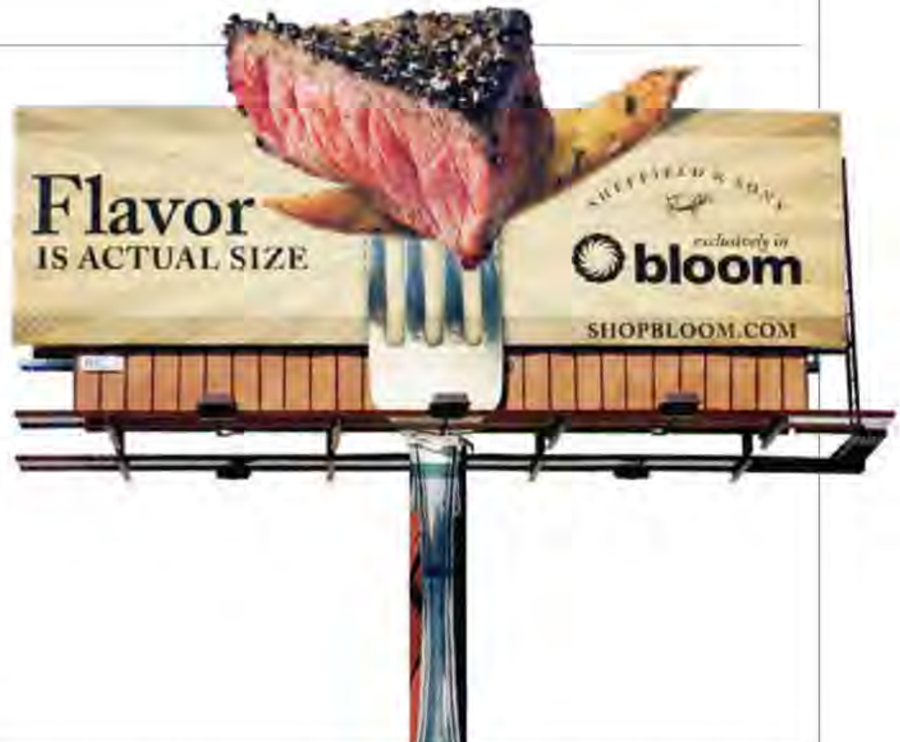
rooms in an effort, it claims, to enhance productivity. In the mornings, the scent combines orange blossom and "tangy effervescent zest." In the afternoon, executives work away while sniffing "an infusion of Mediterranean citrus, fruit, and herbs."

Scent branding is becoming just as prevalent in retail. Researchers believe that ambient scenting allows consumers to make a deeper brand connection, and data has led many other non-scent-related companies to join the fray. Recently, Gaurin, 41, helped create a fragrance for Samsung's stores, which has been cited throughout the industry as a milestone in scent as design. He claims the research, which IFF declined to provide on account of contractual agreements, showed that not only did customers under the subtle influence of his creation spend an average of 20 to 30 percent more time mingling among the electronics, but they also identified the scent—and by extension, the brand—with characteristics such as innovation and excellence.

Although independent research remains scant, the number of companies testing the waters is indicative of a broadening phenomenon. Perfumer Coty's upcoming release of a new Guess fragrance, which will also be used for in-store "spot scenting," is intuitive enough. But Credit Suisse, De Beers, and Sony have all been experimenting with ambient scenting in their retail spaces, too. This month Salisbury (N.C.)-based Bloom grocery stores made history by erecting the first-ever scented billboard, which sprays a charbroiled smell over a highway via a giant fan.

Not surprisingly, many businesses are skeptical about the benefits of investing in a signature scent, while others prefer their olfactory experiments remain a secret. Still, Big Fragrance, which includes companies such as Firmenich, Givaudan, Symrise, and, in particular, IFF, predicts an enlarging market if it can gather enough research to make a definitive case that scents evoke specific emotional responses that prepare consumers to spend. And while there has been a lot of intra-industry discussion about engineered olfaction's potential benefits to various products—scented cell phones are a hot topic, as is improving the airline experience—fragrance companies have been given few opportunities to put their talents to the test. (Visa's collaboration with IFF on a forthcoming scented credit card is a notable exception.)

That may be about to change, as evidence of the powerful relationship between the olfactory bulb and the brain's limbic system, the part that handles memories and emotion, appears increasingly compelling. In 2007, in collaboration with IFF and the nonprofit Cosmetic Executive Women, the Raymond Poincaré Hospital in Garches, France, experimented with scent on patients suffering serious trauma resulting in the loss of memory and, in some cases, speech. One patient, who lost the ability to speak after a motorcycle accident, uttered his first words after being presented with the smell of tar. (After nine months of not being able to talk, his first word was "tar.") Another patient, who had emerged from a 12-month coma, was moved to words after the staff exposed him to the smell of a certain bread that had left an imprint from his childhood.



The Bloom billboard on N.C. Highway 150 in North Carolina emits a charred smell

Advances in scent harvesting and dispersal technology, or the ability to deconstruct scent compounds and recreate them, means perfumers can now produce virtually any scent. As documented in Martin Lindstrom's book *Brand Sense*, a Rolls-Royce investigation into customer complaints that the luxury cars had lost their feeling of excellence fingered scent as the culprit. The automaker responded with "a chemical blueprint" for the smell of the 1965 Silver Cloud. "In total, 800 separate elements were found," Lindstrom writes, including fuel, underseal, and felt. The smell is now applied beneath the seats of each car as it comes off the line. As of 2003, Cadillac began processing scent into the leather of its seats. They called it Nuance.

Rolls-Royce's recreation of the ambience of the 1965 Silver Cloud included the scents of fuel and felt

Starting this fall, you can even get a master's degree in scent design. In April, Parsons New School for Design in New York hosted a conference to honor the launch of an transdisciplinary master's program that includes olfaction. As part of a "Scent as Design" seminar, organizers enlisted luminaries from various fields to collaborate with fragrance experts. Among the first explorations is furniture: a butcher block that suggests the meaty whiff of being inside a butcher shop. Another is the South Bronx housing project imbued with the scent of happiness.

While the residents of Sister Thomas appear to be guinea pigs for an emerging industry, Carter sees ambient scenting as a "no-brainer," a practical tool to be used in the national effort to re-green America's inner cities. Jovanovic may have said it best while spritzing L'Eau Vert du Bronx du Sur in a communal bathroom: "It's impact on behavior on a social level!" B



Flavia asserts its coffee drinks are immune to the risk of "cross-flavor contamination."

Single-Serve Showdown

Keurig and Flavia are dueling for office kitchenette supremacy

By Benjamin Wallace

Keurig and Flavia are the Coke and Pepsi of cubicle coffee. According to a 2009 report by *Automatic Merchandiser*, they've dominated offices nearly equally for the last half decade. Flavia had 362,500 systems in place in the U.S. as of last year, while Keurig had 378,420. "Everyone knows Keurig from the home marketplace," says Steve Serino of BostonBean Coffee, which distributes both. "But Flavia is focused on becoming the leader in the office."

No one will confuse either with a well-pulled single-estate ristretto, but they represent an improvement over Pyrex on a hot plate. The case for Keurig—which owner Green Mountain Coffee Roasters says is derived from the Dutch word for excellence—is simple. Its pods, or K-Cups, include nitrogen-flushed real ground coffee from brands such as Newman's Own and Wolfgang Puck. (Keurig has a portfolio with more than 250 flavors.) Flavia, owned by Mars, uses packets of liquid-coffee concentrate and offers 35 or so mainly generic flavors.

THE POD SQUAD



Through its partnerships with Newman's Own, Wolfgang Puck, and others, Keurig offers more than 250 different flavors.



Flavia is focusing its attention on the office market by teaming up with roaster Alterra and claiming substantive advantages over its archrival.

Having previously made small inroads in the home market, Flavia is now focusing entirely on Corporate America, branding its offerings by selling hot chocolate under the Mars brand Dove and teas under the Bright Tea umbrella. Starting this fall its coffee will be sold under the brand Alterra, with which Mars is partnering. (The name Flavia will only describe the machine itself.) Flavia also claims substantive advantages over Keurig's pod squad. For instance, there's no danger of the dreaded "cross-flavor contamination"—coffee residue, say, in your green tea—since the contents of its packets, unlike Keurig's, never touch the machine.

And Flavia claims a leg up in the cappuccino department by offering independent packets of milk, whereas Keurig offers pods containing milk and coffee together. "I'll let consumers decide," says Rich Surmaitis, global vice-president for marketing at Mars, "but it's not an authentic drink!" A more insidious selling point sometimes whispered by distributors is that with Flavia, there's no worry about employees swiping K-Cups for their home machines.

While Keurig and Flavia beat up on each other, some companies are mulling a post-pod future. Elliott Slutzky, CEO of Chicago-based office distributor Coffee Unlimited, says they favor greener, more cost-effective devices that make single servings from beans, like the Starbucks Interactive Cup Brewer. At these companies, Slutzky says, "Flavia and Keurig are overkill." B

TOP: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

Etc. Wealth



Invest in

Exploiting the Turmoil in Europe

Debt contagion? A falling euro? Causeway's Sarah Ketterer refuses to waste a crisis

Investors worry that problems in Greece will spread. In reality, only governments face a debt crisis. The balance sheets of most private companies are in fine shape. Even if European economies remain sluggish, many top companies should thrive. Since dividend yields rise as stock prices fall, many European stocks now yield more than government bonds—a solid indicator that shares are cheap.

One of my favorites is Sanofi-Aventis, a French drugmaker that yields 5 percent. Based on this year's [earnings] estimates, the price-earnings ratio is 7. In the past, the p-e multiple was often in the mid-teens. Major drug stocks have languished in recent years because of concerns about patent expirations and the uncertainties surrounding U.S. health-care legislation. Sanofi-Aventis suffers from the additional problem of being based in Europe, but it has a fortress balance sheet and a promising pipeline of drugs. U.S. legislation should not prevent the drugmaker from reporting growing sales and earnings.

A lot of investors are also concerned that the 14 percent drop in the euro against the dollar this year is a sign the European economy is weakening. In fact, the decline of the euro is a big plus for many companies. The gradual depreciation is making exports less expensive, and many top European companies get most of their sales abroad. The decline in the euro will hurt the value of European stocks for U.S. investors, but increased export sales should help to boost sales and compensate for currency translation losses. A strong exporter is EADS, owner of Airbus. Sales will be strong in emerging markets. Wealthy Middle Eastern countries are buying new planes at a time when U.S. airlines are flying aging fleets. [On June 8, Emirates Airline announced an order of 32 A380s.]

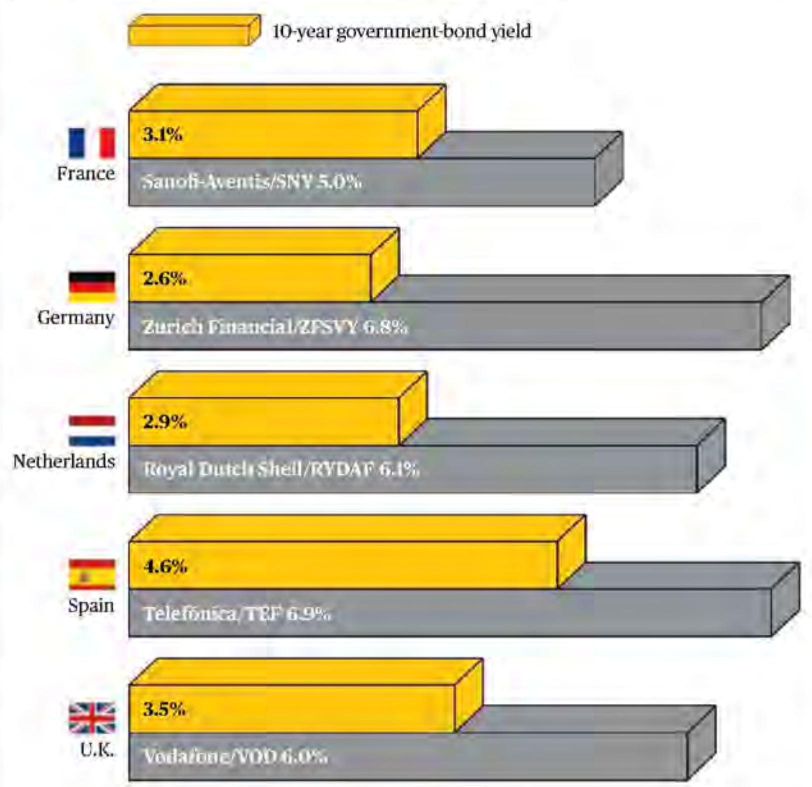
Some European stocks are particularly undervalued because the market has failed to recognize that unwieldy conglomerates have disposed of weak units and begun to focus on their strongest products. We have bought AkzoNobel, a big Dutch maker of paints and specialty chemicals. The company sold a weak health business a few years ago, Organon Biosciences, and began focusing on industrial businesses.

In the past, we've underweighted Japan. Lately we've been increasing exposure because many stocks are depressed. Investors worry Japan has high debt levels and weak growth prospects. Because the population is aging rapidly, demand could remain subdued for many products, but some companies seem poised to thrive. My fund owns insurer Sony Financial. It has a strong lineup of products aimed at aging consumers who must save more to cover long retirements.

Many Japanese manufacturers are also cheap because investors view them as unexciting cyclical businesses. Some companies have enjoyed booming sales to China, though. I like Fanuc, a maker of robotics and factory automation equipment. With vehicle sales climbing in China, Fanuc is reporting a spurt of orders. —*As told to Stan Luxenberg*

DIVIDEND YIELD DIVAS

More European stocks now have dividend yields above those of their governments' 10-year bonds



DATA: BLOOMBERG, CAUSEWAY CAPITAL MANAGEMENT

The decline of the euro is a big plus for many [European] companies. The gradual depreciation is making exports less expensive

The Stats: Sarah Ketterer is chief executive officer of Causeway Capital Management, which oversees $10.3 billion in assets. She is also portfolio manager of the $1.8 billion Causeway International Value Fund (CIVVX). The fund ranks in the top quintile of peers for the year ended June 7 and in the top third for three years, according to Morningstar.

BRUSH: BRAND X PICTURES/GETTY IMAGES

Packing the Perfect Bag

The comprehensive guide to the bags, gadgets, and techniques you need for a four-day summer business trip. *By Michael Slenske*

The Luggage



Weight: 6 lbs
Height: 19.5"
Width: 15"
Depth: 9"
Price: $395

Roller

Tumi Super Leger International Carry-On
Lighter than most midsize rollers (which weigh around 15 lbs). It has an abrasion- and water-resistant nylon shell, an aircraft-grade aluminum handle, and easily maneuverable in-line skate wheels.



Weight: 7 lbs
Height: 15.5"
Width: 13.5"
Depth: 8"
Price: $250

Under-Seat

Zero Halliburton Hybrid Wheeled Boarding Tote
Escape the tyranny of jammed overhead bins with this half-poly, half-ballistic-nylon roller. Its well-protected interior holds suits, shirts, and shoes but the bag still fits under the seat. The 39.5-inch handle works for tall travelers.

Weight: 3 lbs
Height: 11.3"
Width: 20.7"
Depth: 10.5"
Price: $225



Duffel

Matt Singer Weekend Bag
A classic roller alternative. The tightly woven shell keeps its shape and develops a rugged-looking patina with use. Handle grips flip for different weights, and there are three slip pockets and slots for two pairs of shoes.

Weight: 3 lbs
Height: 40"
Width: 23"
Depth: 2"
Price: $515



Garment Bag

Moore & Giles Gravely Garment Bag
For the dapper frequent flier, this lasting carrier has a black twill shell oiled to resist the elements and soft full-grain-leather trim. The surprisingly spacious main compartment has ample pockets and a fastener that holds hangers tight.

Portable Office Necessities



Tumi Mobile Power Pack
Contains enough energy for five charges of your phone, iPod, camera, or Kindle ($130 at tumi.com).



Verizon MiFi 2200
This pocket-size mobile hotspot connects with up to five devices ($270 at verizonwireless.com).



Yuento Music Balloon
A 1.5 oz., golf-ball-size speaker for your computer, phone, or MP3 player ($48 at Flight 001, New York).

Suit-Packing Supplies

Simple secrets to keeping business suits wrinkle free

Hanger
Must be wood, with a rubber bar to hold pants in place without clips. Try the Container Store's Walnut Suit Hanger with Ribbed Bar, $10.

Tissue Paper
Crumple into arm-shaped tubes and slide into sleeves from the top. Kreinik Acid-Free Tissue Paper won't fall apart. $8.25 for 12 sheets at Kmart.

Garment Bag
No dry cleaner cellophane, please. Heavy-gauge plastic—like the PEVA Clear Suit Bag, $13 at the Container Store—protects clothes when bags are thrown around.

(ADVICE FROM COLIN HEYWOOD, ANDERSON & SHEPPARD BESPOKE TAILORS, LONDON)

▶ **Ultimate packing read:** *The Art of Travel*, Alain de Botton (tip from Idlewild Books, New York); ▶ **Perfect pre-takeoff songs:** *Stillness Is The Move*, The Dirty Projectors, *Maybe We*

The Dopp Kit

The ultimate in unisex, TSA-approved, high-maintenance-sustaining essentials

J.W. Hulme Green Canvas Travel Kit ($120) Water- and mildew-resistant with a cognac-colored leather trim.

Benadryl Allergy Quick Dissolve Strips ($6) Assuages allergic reactions and/or helps you fall asleep.

Living Proof No Frizz Conditioner ($10 for 2 oz.) Perfect for humid climes. Plus, a few drops of water turn it into a light hair gel.

Ms. & Mrs. Stain Remover and Deodorant Towelettes (part of Hemergency kit, $25).

C.O. Bigelow Peach Nut Oil Liquid Soap ($5 for 2 oz.)Use as a body wash, shampoo, or gentle detergent for laundering in the hotel room sink.

Frais Hand Sanitizer ($3.50)Tiny (at .2 oz.) and made with botanicals to be less drying than traditional antibacterial gels.



Editions de Parfums Frederic Malle 10 ml Refill Spray (three for $90) A fancy, concentrated French scent (Géranium pour Monsieur) for a fraction of the big-bottle cost.

Preserve Toothbrush and Razor ($3.29, $8.49) Send these back once you're done (print postage on preserveproducts.com) and they'll be recycled to create picnic tables or park benches.

NPW Shaving Paper ($6)Add water to two sheets to create a thick shaving lather.

The Technique

The best way to pack four days' worth of clothes: We tested three methods

Folding

How to: Fold pants and lay at the bottom of your case. Next, shirts (arms bent behind, body doubled over) and then jackets, front shoulders together, facing inward, with the arms wrapped around one side. **Packing Time:** 10:23 minutes. **Wrinkle Factor:** 4 out of 10. Pronounced, hard creases; few small wrinkles. **Takeaway:** Packs the most in, but the wrinkle factor makes this risky for quick trips.



Rolling

How to: Roll dry-clean items (suits, shirts) loosely from the collar or waist down, then place in middle of the bag. T-shirts, sweaters, and jeans can be rolled tightly and placed on the sides like a firewood pile. Shoes, socks, and dopp kit go at bag's ends. **Packing Time:** 9:44 minutes. **Wrinkle Factor:** 3 out of 10. Erased by a quick shower steam. **Takeaway:** Easy, efficient, and with the fewest wrinkles: the all-around best.

The Best Method



Bundling

How to: Wrap clothes around a "core object" (dopp kit and/or shoes). Begin by aligning pants to the top of your core and wrapping legs around the top. Follow in alternating directions with suit coats (collars lined up with the core), sweaters, shirts. **Packing Time:** 23:24 minutes. **Wrinkle Factor:** 6 out of 10. Small and easily steamed away. **Takeaway:** No hard creases, but takes time and suitcase space.



PHOTOGRAPHS BY DAVIES+STARR FOR BLOOMBERG BUSINESSWEEK

Most Travel-Friendly Clothes



BROOKS BROTHERS NON-IRON SLIM FIT SHIRT: WRINKLE-PROOF BUT STILL SOFT. $80 AT BROOKSBROTHERS.COM.



UNIS IAN BLAZER AND GIO CHINOS IN MARINE: LIGHT, CLASSIC, AND INEXPENSIVE FOR ITALIAN TWILL. $800 AT UNISNEWYORK.COM.



FOX RIVER X-STATIC XPANSE SOCKS: SILVER-COATED NYLON ELIMINATES ODOR AND COOLS SWEATY FEET. $13 AT FOXSOX.COM.



VILEBREQUIN SOLID CLASSIC MOREA TRUNKS: FOR SWIMMING OR RUNNING. $170 AT VILEBREQUINONLINESTORE.COM.



EXOFFICIO BOXERS: WASH THEM IN THE SINK AND THEY TAKE ONLY A FEW HOURS TO DRY. $25 AT REI.COM.

Can Slip Away, Barbara Lynn (Other Music, New York); ► **Onboard exercise:** Works abs: While sitting, inhale deeply. Exhale and lift thighs off your seat (Satori Yoga, San Francisco).

Etc. Next Life

From Courtroom Battles To Harvesting Hops

Worthington's $1 million gift to Oregon State University will, in large part, fund an aroma hop breeding program

After 20 years of legal sparring, Roger Worthington took on a new calling

In the courtroom, Roger Worthington was someone you wanted in your corner. A self-confessed alpha male, his intensity was put to good use representing victims of asbestos-related cancer. "I lived that life full-in and full-on for more than 20 years," says Worthington, 49, who won more than $1 billion for his clients. Asbestos-related cancer "is an insidious disease and highly preventable. It was a calling for me."

Battling corporate lawyers every day took its toll, though: "When you represent people who are dying, the clock's always ticking. There are so many battles to be fought, and I got tired of throwing down."

As he began to rethink his life, the Orange County (Calif.) lawyer returned to Oregon's Willamette Valley, where he grew up. Worthington remembered countless acres of hop fields surrounding his childhood home of Corvallis, but he returned to a different landscape. The fields had shrunk dramatically, and a recent blow came when beverage giant InBev canceled some contracts with local farmers after buying Anheuser-Busch in 2008.

While having a beer together in 2009, Worthington and a boyhood friend, former Nike executive Jim Solberg, hatched a plan to open a hop mill, which would compress aroma hops into pellets. (The hops are added to give beer more flavor and aromatics.) "Beer is something delightful and transcendent," Worthington says. "I wanted to make people happy." The goal: Have their company, Indie Hops, supply the master brewers of Portland, a mecca for craft beer. Worthington shoulders the costs. "I've been hit many times by buddies coaxing me to invest in 'sure winners' only to see deals, and friendships, blow up," he says. This time it was different—even if people warned him that a payoff might take years. "Everyone told us we had a great vision, but to be prepared to spend a lot of money to perhaps make a little."

The $2 million Indie Hops mill opened in late March; Corvallis' Block 15 Brewery and San Diego's Karl Strauss Brewery have already used its pellets. While Indie Hops has received interest from other breweries, including BridgePort in Oregon, many are still testing its hops. Worthington figures he'll lay out $4 million before seeing any return. "I believe in this," he says. "That's enough for me." —*Chris Taylor*





Indie Hops will have 16 to 20 varieties of hops

THE ECONOMICS OF CRAFT BEER

Cash outlay: $3.5 million-plus so far, including the $1 million donation to Oregon State University for hop research

Largest expense: $2 million to build a hop mill in Hubbard, Ore.

Expected outlay before seeing an income: $4 million for farm contracts, operations, research and development, marketing, and sales

Indie Hops acres planted in Willamette Valley, 2010: 100

Indie Hops price for its pellets: $9.75 per pound, on average

Number of hop varieties, worldwide: 100-plus

Growth of craft brewing industry in 2009: 10.3%

Number of craft breweries in the U.S.: 1,558 as of Apr. 30

Barrels of beer sold by craft brewers in 2009: 282,584,685 gallons, equal to 3,014,236,640 12-oz. bottles

Craft brew retail sales, 2009: $7 billion

DATA: INDIE HOPS, BREWERS ASSN.

WORTHINGTON: PHOTOGRAPH BY BRAD SWONETZ FOR BLOOMBERG BUSINESSWEEK; HOPS: ULRICH KERTH/GETTY IMAGES

4G service won't be deployed in Los Angeles, New York, and San Francisco until later this year.



A Phone Too Smart For Its Own Good

Sprint's 4G network is pretty cool —if you live in Milledgeville, Ga.

By Rich Jaroslovsky

Sprint's new EVO smartphone is the first ever to run over a 4G wireless data network named WiMax. 4G, or fourth generation, is designed to deliver faster speeds for downloading movies and uploading live video. But EVO requires a great deal in the way of tradeoffs, and WiMax, so far, is more important for the bragging rights it gives Sprint than the benefits it provides consumers.

The EVO is made by Taiwan-based HTC, which turns out the most impressive handsets this side of Apple. Its 4.3-inch screen—the same size as on HTC's recently released HD2—dwarfs the 3.5-inch screen on the iPhone 3GS and new iPhone 4. Just above the screen is a front-facing camera, perfect for video chatting. The slightly bowed back contains an 8-megapixel camera with dual flashes and a handy kickstand for propping the phone up to, say, watch a movie on an airplane tray table. The EVO comes with HTC's Sense user interface, which coexists well with Google's Android 2.1 mobile operating system, and sells for $199.99 after a $100 rebate on a two-year contract. In short, nice phone, nicely made, at a decent price.

Sprint EVO

The world's first-ever smartphone to run over a 4G network sells for $199.99 after a $100 rebate



Sprint's pitch, however, is more about the network than the hardware. For now, that network is a work in progress. Sprint says 4G has been deployed in 33 markets. Some are major—Atlanta, Chicago, Dallas—while others are anything but: Milledgeville, Ga.; Salem, Ore.; York, Penn. Los Angeles, New York, and San Francisco are scheduled for later in 2010.

If you're lucky enough to live in Milledgeville, you'll likely see better performance, though perhaps not as much as Sprint's claim of up to 10 times faster speeds. You'll also probably see worse battery life; the EVO couldn't make it through a normal day's use with the 4G radio turned on. Then there's WiMax's future to consider. Verizon and AT&T are working on 4G networks using a rival standard—LTE, for Long Term Evolution—that has been embraced by many international carriers. If WiMax suffers against the competition, Sprint customers will suffer, too.

Ironically, just as Sprint was introducing its 4G network, Apple was unveiling its iPhone 4—which, name aside, runs only on 3G networks. Despite initial interest in Sprint's new network, in any battle of the 4s, Apple is likely to remain No. 1. B

ILLUSTRATION BY CHRIS SILAS NEAL; PHOTOGRAPH BY DAVIES+STARR FOR BLOOMBERG BUSINESSWEEK

A highly adept risk manager, Ace Greenberg practiced a disciplined strategy: "Unload losers, ride winners"



Ace's Wild Ride

The former head of Bear Stearns doesn't pull any punches—as usual. *By Norman Pearlstine*

The Rise and Fall of Bear Stearns
By Alan C. Greenberg with Mark Singer
SIMON & SCHUSTER; 224 pp, $26.00



"You can read about it in my book." That was Ace Greenberg's tart reply to *The New York Times* when asked, in May 2008, what advice Bear Stearns CEO Jimmy Cayne ignored prior to the firm's collapse two months earlier.

Alan C. "Ace" Greenberg, the trader who, over a career spanning more than six decades, built Bear into a powerhouse, has now written that book, *The Rise and Fall of Bear Stearns*, with Mark Singer, a writer for *The New Yorker*. The book is long on diatribe and gossip. Its analysis of Bear's demise—covered in very few pages—is more cursory than one would have hoped.

During the years Greenberg ran Bear Stearns, he mentored James E. "Jimmy" Cayne. Their relationship grew strained as early as 1988, when Cayne became Bear's president. It deteriorated further as Cayne gained power from Greenberg. In addition to blaming Cayne for creating the environment that led to Bear's collapse, Greenberg's book seeks to rebut William D. Cohan's *House of Cards*, which portrays Ace as sometimes ruthless and small-minded. He asserts that Cohan accepts Cayne's "fanciful history of [Cayne's] career" at Greenberg's expense. Greenberg is more successful in attacking Cayne than Cohan, whose well-balanced, exhaustive analysis remains the definitive study of Bear's epic fall.

Greenberg says the firm's profits grew sharply under Cayne's leadership. He also says Cayne was a dope-smoking megalomaniac more interested in his bridge game than in supervision of the firm. He downplays Cayne's assertion that Bear Stearns was the victim of a "bear raid" by short-sellers who had spread false rumors of its imminent bankruptcy. Instead he blames Bear—especially the fixed-income department—for using too much leverage to build its mortgage-backed securities portfolio.

Despite his reputation as a highly adept risk manager, Greenberg says his warnings to Cayne that the firm was overleveraged were ignored. Greenberg admits, however, that he failed to raise the alarm with Warren Spector, who headed Bear's fixed-income department. His explanation—that Spector "insisted upon being 100 percent in control of his department"—is unconvincing, given Greenberg's well-known enthusiasm for his own opinions.

In an interview with Cohan, Cayne dismissed his former mentor: "There isn't anybody that would tell

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you they choose him as their best man, or best friend, or one who they would have lunch with, or go on a trip with, or socialize with, or whatever. They don't exist. He had one friend—me."

Cayne also told Cohan that Greenberg's "narcissism" was behind his more eccentric charitable donations, including his 1998 gift of $1 million to provide poor men with Viagra prescriptions. Greenberg says that most people reacted favorably to his gift, and chronicles several of Cayne's grandiose moments. "Why was it that a single elevator in the lobby had to be reserved for one person?" he asks. When Cayne agreed to limit his reservation of the elevator to an hour a day, Greenberg notes that the hour was from 8 to 9 a.m., "just when everybody needs to use it."

Greenberg also recalls Cayne's absence from executive committee deliberations over a proposed $10.7 billion commitment, because, he writes, it conflicted with a regular summer golf date that he reached every Thursday afternoon by helicopter. "This particular example of Jimmy's egotism, tone deafness, and clueless contempt for the rest of us still provokes my outrage," he says.

Greenberg and Cayne differed over whether Bear's executives should have held on to the stock they received as part of their compensation. Greenberg had sold millions of shares over the years, enabling him to withstand the firm's collapse, while Cayne, who considered such sales inconsistent with leadership, held on to his and suffered paper losses of nearly $1 billion when Bear was sold to JPMorgan Chase in March 2008.

The Cayne-Greenberg dogfight that ensued overwhelms the book's backstory: Bear Stearns' rise to prominence and power and Greenberg's remarkable role in building it. That story is also worth remembering.

Ace grew up in Oklahoma City, where he was a high school track and football star. After graduating from the University of Missouri, he came to New York. He joined Bear Stearns, then an investment firm with 125 employees, in March 1949. By the time he turned 40 he was effectively running it, his power confirmed in 1978, shortly after the death of Salim L. "Cy" Lewis. During Lewis' last years in control at Bear, he and Greenberg argued about many things—including Lewis' son, Sandy, whom Cy wanted to hire despite a firm rule that prohibited nepotism. Greenberg prevailed. Sandy Lewis told Cohan that his father "hated" Greenberg, a man "so cold my father used to say he pissed ice water."

Under Greenberg's control, Bear's profits grew quickly. At its peak it employed almost 15,000 people. While most Wall Street firms preferred to hire Ivy Leaguers, Greenberg looked for people with "PSD" degrees, by which he meant "poor, smart, and a deep desire to become rich." Along the way, he developed a disciplined style of investing—"unload losers, ride winners"—that served him and hundreds of loyal individual clients well over the years.

Greenberg liked people with "PSD" degrees: "poor, smart, and a deep desire to become rich"

I became one of those clients 11 years ago as an executive and editor at Time Warner Inc. I had accumulated vested stock options that, if exercised, would represent the majority of my net worth. The options gave me nightmares. Should I hold? Should I sell?

My tax accountant—the now-notorious Kenneth I. Starr, who was recently indicted for allegedly bilking his customers—arranged for me to call Greenberg. Ace, who answered his own phone, told me to meet him in his office, a desk on the Bear trading floor, the next day at 7 a.m. Over coffee he asked why Time Warner used EBITDA (earnings before interest, taxes, depreciation, and amortization) when reporting results instead of "EBITDARE." "What's 'EBITDARE?'" I asked. I had never heard the term during a long career in business journalism. "What do 'R' and 'E' stand for?"

"Rent and electricity," he replied. "If they are going to mask their lack of earnings with all that other stuff, why don't they throw in rent and electricity as well? Exercise every option and get out of the stock."

I followed his succinct advice. A couple years later, Time Warner merged with AOL, destroying Time Warner's share value and the value of its options. Ace's counsel, dispensed over a few seconds, was typical of the wisdom that made him a hero to satisfied customers like me.

If Ace's story ended then, his autobiography would have justly celebrated one of Wall Street's greatest stockpickers and executives. That, alas, was not to be. Instead, his and our bitter memories of Bear Stearns' collapse define his coda. B

Contributors' Corner



Complicit
By Mark Gilbert
BLOOMBERG PRESS;
182 pp, $24.95

In *Complicit*, Bloomberg News columnist Mark Gilbert dubs Realtors, lenders, homeowners, bankers, ratings agencies, traders, investors, lawyers, accountants, and regulators the "silent conspiracy of the well rewarded." While his indictment is serious, the tone is light; Gilbert artfully connects the Chinese farmer "who quits his village to sew T-shirts in a factory" and a Manhattan hedge fund manager who "makes credit default swap market bets at prices he never would have entertained a year earlier." —*Ira Boudway*

Bloomberg Businessweek (USPS 080 900) June 21 – June 27, 2010 (ISSN 0007-7135) S T Issue no. 4184. Published weekly, except for a double issue in August and one in December, by Bloomberg L.P. Periodicals postage paid at New York, N.Y., and at additional mailing offices. Executive, Editorial, Circulation, and Advertising Offices: Bloomberg Businessweek, 731 Lexington Avenue, New York, NY 10022. **Postmaster:** Send address changes to Bloomberg Businessweek, P.O. Box 8418, Red Oak, IA 51591-1418. Canada Post Publication Mail Agreement Number 41989020. Return undeliverable Canadian addresses to DHL Global Mail, 355 Admiral Blvd-Unit4, Mississauga, ON L5T 2N1. Email: bwkcustserv@cdsfulfillment.com. QST#1008327064. Registered for GST as Bloomberg L.P. GST #12829 9898 RT0001. Copyright 2010 Bloomberg L.P. All rights reserved. Title registered in the U.S. Patent Office. Single Copy Sales: Call 800-298-9867 or email: busweek@nrmsinc.com. Subscriber Services: Call 800-635-1200 or log onto our website: http://www.businessweek.com/custserv/manage.htm. Photocopy Permission: Where necessary, permission is granted by copyright owner for those registered with the Copyright Clearance Center (CCC), 222 Rosewood Drive, Danvers, MA 01923 or email the CCC at info@copyright.com. Custom Reprints: For customized bulk reprints of Bloomberg Businessweek articles, contact The YGS Group at 800-360-5549 or email businessweekreprints@theYGSgroup.com PRINTED IN THE U.S.A.

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Joe Torre

"I could get the money back if we won this, that, and the other thing. I was insulted that they thought I needed to be motivated financially."

On walking away from the Yankees,
being lured by the Dodgers,
and the limits of being a manager



The meltdown started in 2004, when we lost to the Red Sox after going up three games to none in the [American League] Championship Series. I just couldn't agree with everybody who felt it was a failure. My players worked their tails off and we did as well as we could. Just getting to the postseason seemed like a great accomplishment. I couldn't be disappointed in the performance of my team.

I was offered a very nice contract from the Yankees [after the 2007 season] but it was a reduction in pay. I could get the money back if we won this, that, and the other thing. I was insulted that they thought I needed to be motivated financially to go out there and do a better job. That's when I walked away.

My relationship with George Steinbrenner was great. He was the boss and I accepted that. When you take a job, you don't just accept the pats on the back. You have to accept the kicks in the pants. He's allowed to be unfair—he's the owner of the team. I knew if I didn't shoot back at him, issues would eventually disappear, and for the most part they did.

I was going to retire, but the Dodgers had expressed interest in having me on board. My daughter was 11 years old at the time and I was very reluctant to uproot her from New York, but the Dodgers' offer was appealing. Like the Yankees, they were a storied franchise, and having grown up in Brooklyn, I was fascinated by their history. I was curious to see whether managing could be fun again.

What motivates me now is the game itself. I think I'm winding down my career here at some point. I have learned that it's important to see the bigger picture and stay calm under pressure. I never want my players to feel they have disappointed me. Winning gives you the confidence to implement certain things. People begin to trust that you know what you're doing, but there are so many variables. Every season brings a new group of personalities on the field, and I never forget that the game belongs to them.

—*As told to Diane Brady*

PHOTOGRAPH BY BRYCE DUFFY FOR BLOOMBERG BUSINESSWEEK


TOYOTA
moving forward
"everyone deserves to be safe."
We're investing a million dollars an hour to enhance our safety and technology.
No matter who you are or what you drive, everyone deserves to be safe. That's why we're spending a million dollars an hour on research and development. One result of this investment is the Star Safety System.™ Now standard on all our vehicles, the Star Safety System™ is a combination of five accident avoidance technologies that help keep you in control and out of harm's way. In fact, no other manufacturer has more 2010 Insurance Institute for Highway Safety Top Safety Picks than we do.* Because at Toyota, we know there's nothing more important to you than your safety. For more on our safety innovations, visit toyota.com/safety
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